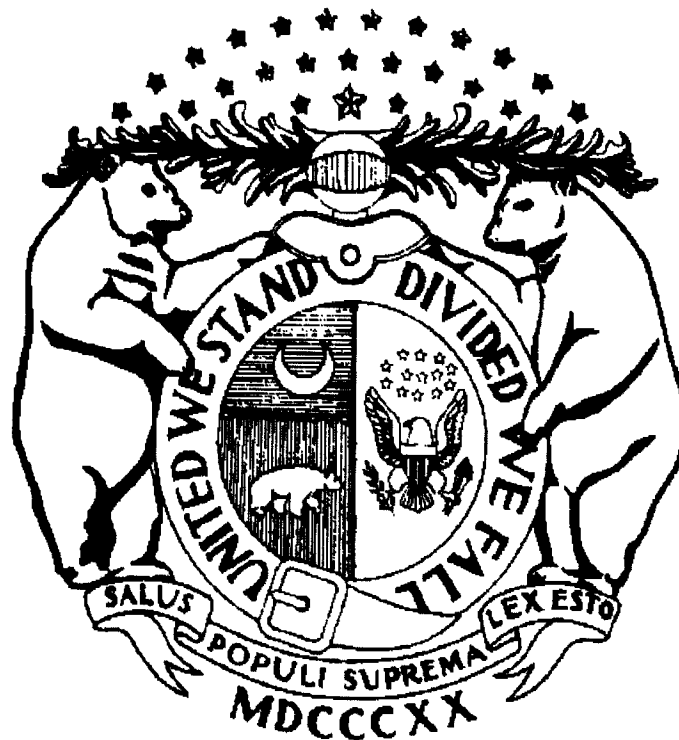


**REPORT OF THE
ASSOCIATION FINANCIAL EXAMINATION OF
EMPLOYERS REINSURANCE CORPORATION**

**AS OF
DECEMBER 31, 2003**



**STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI**

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Overland Park, Kansas
February 8, 2006

Honorable Alfred W. Gross, Commissioner
Virginia Bureau of Insurance
Chairman, Financial Condition (E) Committee

Honorable Jorge Gomez, Commissioner
Wisconsin Department of Insurance
Secretary, Midwestern Zone, NAIC

Honorable Linda S. Hall, Director
Alaska Division of Insurance
Secretary, Western Zone, NAIC

Honorable W. Dale Finke, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Ladies and Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

Employers Reinsurance Corporation

hereinafter referred to as such, as ERC, or as the Company. Its administrative office is located at 5200 Metcalf Avenue, Overland Park, Kansas 66202, telephone number (913) 676-5200. This examination began on August 30, 2004, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

The prior full scope association financial examination of ERC was made as of December 31, 2000, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC), with the Southeastern and Northeastern zones also participating.

The current full scope association financial examination covered the period from January 1, 2001, through December 31, 2003, and was conducted by examiners from the States of Missouri and Nevada, representing the Midwestern and Western Zones of the NAIC, respectively. This examination was performed concurrently with examinations of the Company's subsidiaries, Westport Insurance Corporation (Westport or WIC) and First Specialty Insurance Corporation (First Specialty or FSIC). The examination was updated to review the loss reserves recorded as of December 31, 2004.

This examination also included the material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

Procedures

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance (MDI) and statutes of the State of Missouri prevailed.

The examiners relied upon information supplied by the Company's independent auditor, KPMG, LLP, of Kansas City, Missouri, for its audit covering the period from January 1, 2003, through December 31, 2003. Information relied upon included confirmations, account reconciliations, and narrative descriptions of processes and controls.

Comments - Previous Examination

The previous financial examination of ERC was conducted by the MDI for the period ending December 31, 2000. Listed below are the comments, recommendations, and notes from the previous examination report, the Company's response, and the findings in the current examination.

Dividends

Comment: It was noted that the Company paid an extra-ordinary preferred dividend in 2000 without prior approval of the MDI as required by Section 382.210 RSMo (Notice of Extraordinary Distributions). It was recommended that ERC must ensure compliance with all applicable laws and regulations prior to implementation of any transaction.

Company's Response: The Company stated that it has implemented internal procedures to ensure compliance with applicable laws and regulations, and has timely filed any required regulatory documentation prior to any dividend transactions.

Current Findings: The Company received prior approvals from the MDI for all extra-ordinary dividends that were paid during the examination period.

Conflicts of Interest

Comment: It was noted that several officers and directors did not complete conflict of interest statements during 2000 and 2001. It was recommended that all officers and directors execute a conflict of interest statement annually.

Company's Response: The Company stated that it has implemented an online form for completion, created a repository of conflict of interest statements, and will ensure that all officers and directors execute such statements annually.

Current Findings: Several officers and directors did not complete conflict of interest statements during the examination period. However, the Company has implemented new controls and as a result, it was noted that all officers and directors completed conflict of interest statements in 2004.

Management of Industrial Risk Insurers (IRI)

Comment: It was noted that the Company was unable to provide the minutes of the board of directors meetings of IRI. It was recommended that the Company have the minutes and all other corporate documents of IRI available for review in the future.

Company's Response: The Company stated that it would maintain copies of the minutes of IRI's Board of Directors' meetings and all corporate documents with respect to IRI for review during future examinations.

Current Findings: Meeting minutes were provided for the IRI's Board of Director's meetings held during the examination period.

Intercompany Agreements

Comment: It was recommended that the Investment Service Agreement between GE Investment Management, Inc. and ERC and its subsidiaries should be updated to reflect the merger of Puritan Excess and Surplus Lines Insurance Company into Westport Insurance Company with WIC being the surviving corporation.

Company's Response: The Company stated that this agreement was terminated and a new agreement concerning investment services with GE Investment Management, Inc. was executed and approved by the MDI.

Current Findings: The Investment Service Agreement, effective January 1, 1996, was replaced by the Investment Management and Services Agreement, effective May 1, 2002, with GE Asset Management, Inc., WIC, and FSIC. A description of this agreement is included in the Intercompany Agreements section of this report.

Intercompany Agreements

Comment: It was noted that a Master Cost Allocation Agreement with ERC Asia Pacific Property Limited was not disclosed in the annual Form B registration statements filed during the prior examination. Costs incurred under this agreement were also not disclosed in Schedule Y of the Annual Statement. The Company was directed to ensure proper disclosure of intercompany agreements and costs in the future.

Company's Response: The Company stated that it discloses the costs from ERC Asia Pacific Property Limited in Schedule Y and timely discloses intercompany transactions as directed.

Current Findings: The Master Cost Allocation Agreement with ERC Asia Pacific was properly disclosed in the 2003 Form B filing. The intercompany transactions for this Agreement and other transactions were not reported on Schedule Y – Part 2. See the Intercompany Transactions section of this report for further information.

Intercompany Agreements

Comment: The Company was directed to terminate any and all intercompany agreements that are no longer being utilized.

Company's Response: The Company stated that it would terminate any agreements no longer being utilized.

Current Findings: Several agreements no longer being utilized were still listed on the 2003 Form B filing (Holding Company Registration Statement). However, most of these were terminated and removed from the 2004 Form B filing.

Intercompany Agreements

Comment: For any agreements involving several entities, the Company was directed to ensure that costs are properly allocated to the other entities in accordance with the provisions of each agreement.

Company's Response: The Company stated it would ensure that costs are properly allocated to affiliates in accordance with the provisions of each agreement.

Current Findings: No material problems were noted with the cost allocations for intercompany agreements.

Intercompany Agreements

Comment: For agreements with GE Capital International Services, Inc. (GECIS), Electronic Data Management International (EDMI), and the related Statements of Work (SOWs), the Company was directed to ensure that accounting for costs is completed and reported in such a manner that payments due or made for each SOW can be individually identified and reported as required by the agreements and MDI's approval thereof.

Company's Response: The Company stated that it had implemented an accounting process for tracking and individually identifying payments for SOWs, and has provided the MDI with payment and savings information as requested or where non-disapproval of such agreements has been otherwise conditioned.

Current Findings: The Company provided workpapers that listed the amount of payments made by ERC for each of the SOWs with GECIS and EDM I.

Intercompany Agreements

Comment: The Company was directed to ensure accurate reporting and disclosure of all intercompany transactions in the various schedules and exhibits of the Annual Statement, including Schedule Y and the Notes to the Financial Statements.

Company's Response: The Company stated that it would ensure that intercompany transactions are accurately reported and disclosed in the Annual Statement.

Current Findings: Several intercompany transactions were omitted from Schedule Y during the examination period. A further description is included in the Intercompany Transactions section of this report.

Intercompany Agreements

Comment: It was noted that there were instances where intercompany transaction exist without the underlying agreement and required filing and notification of the MDI. Examples were the payroll services provided by Corporate Payroll Relations (CPARS), the pension services, post-employment pension services, and administration by General Electric Company on behalf of ERC, and the assignment and re-assignment between ERC and WIC with respect to an ownership interest in IRI. For each of these relationships and other transactions, the Company was directed to draw up the underlying agreement governing the transactions in accordance with the applicable Missouri insurance holding company law.

Company's Response: The Company stated that it had drafted agreements for the above transactions and the agreements had been approved by the MDI.

Current Findings: ERC and other affiliates executed a Service Reimbursement Agreement, effective April 8, 2004, with GE for the payroll, pension, and employee benefits services provided by GE. An Assignment Agreement between ERC and WIC, which assigns WIC's ownership interest in IRI to ERC, was executed in August 10, 2004, with a retroactive effective date of January 1, 2001. Although these issues were resolved, other transactions were found to have occurred in the current examination period without a written agreement. Refer to the Intercompany Agreements section of this report for further information on these agreements.

Intercompany Agreements

Comment: It was noted that there were many instances where material intercompany transactions were first implemented by the Company prior to notifying the MDI in violation of the applicable Missouri insurance holding company law. The Company was directed to desist from this practice.

Company's Response: The Company stated that it had identified transactions without underlying agreements, drafted underlying agreements as warranted, and submitted them to MDI for approval as Form D filings.

Current Findings: Intercompany agreements that were entered into during the current examination period were found to have been submitted to the MDI for prior approval, as required.

Insolvency Clauses in Reinsurance Agreements

Comment: The Company was directed to update all of its existing reinsurance agreements so that the insolvency clause in each agreement is in compliance with Missouri Regulation 20 CSR 200-2.100(11)(A), Credit for Reinsurance. The Company was also directed to ensure that future reinsurance agreements comply with this regulation.

Company's Response: The Company stated that it continues to work with the MDI on acceptable language for insolvency clauses to be included in ERC's reinsurance agreements.

Current Findings: As of the date of this report, the MDI and ERC are continuing to work towards an agreement on acceptable language to be included in the insolvency clause.

Reporting Date for Annual Statement Information

Comment: It was noted that the Company's 2000 Annual Statement was based upon a year-end reporting date other than December 31. It was also noted the Company had proposed a year-end reporting date of approximately one week prior to the last business day prior to December 31 in order to facilitate reporting requirements of the ultimate parent company. It was recommended that the Company consistently apply this plan for a year-end cut-off date in the future.

Company's Response: The Company stated that it has consulted with MDI concerning this issue and will ensure consistent application of its year-end cut-off date plan.

Current Findings: Although there were some inconsistencies, in general, the Company closed its 2003 financial statements, as of December 18, 2003. Refer to the Accounts and Records section for further information.

Coordination for Examination Requests

Comment: It was noted that the Company was unable to comply with Missouri Regulation 20 CSR 200-4.010(4) (Time and Limits) which states that an insurer shall provide, within five (5) working days, any records requested by financial examiners during an on-site financial examination. The following recommendations were directed to enable the Company to comply with this regulation: (1) implement procedures that will facilitate on-site examination in the future, (2) train all personnel who are involved or may become involved in the financial examination process about all aspects of the financial examination process, (3) appoint a senior management person to serve as a general coordinator to facilitate the examination process, (4) add resources that will enable the Company to generate, maintain and retrieve supporting documentation upon request, including information from foreign branches.

Company's Response: The Company stated it has conducted staff education designed to facilitate future on-site examinations, and will conduct additional training in anticipation of the next on-site examination. The Company stated that it will appoint a general coordinator and will designate certain individuals to act as day-to-day contact persons to facilitate future examinations. The Company also stated it has added resources to ensure that foreign branch information can be made available in a timely manner.

Current Findings: There were some lengthy delays to receive some of the information requested during the examination. However, the overall coordination and facilitation of the examination process was improved from the prior examination and was acceptable, considering the size and complexity of the Company.

Information Systems

Comment: It was noted that the review of ERC's information systems and related environment was significantly hindered by the limited or minimal cooperation exhibited by the staff responsible for this function. The Company was directed to ensure that information systems personnel provide necessary cooperation and documentation in a timely manner.

Company's Response: The Company stated that it ensure that its information systems personnel will provide necessary information in a timely manner during the next financial examination.

Current Findings: No problems were noted in obtaining documentation or cooperation from the information systems personnel.

Contingent Liability for IRI

Comment: It was noted that ERC had a contingent liability of \$591 million for liabilities of IRI in excess of IRI's available cash. It was recommended that ERC should disclose the amount of such contingent liability in the Notes to the Financial Statements each year.

Company's Response: The Company stated that its loss reserves already reflect the reserves of IRI for which ERC is responsible. Therefore, the disclosure of a contingent liability is not applicable.

Current Findings: It was verified that the loss reserves of ERC included \$843,696,000 of gross loss reserves from IRI. Thus, there does not appear to be a need for a contingent liability disclosure.

HISTORY

General

The Company operates as a stock property and casualty insurer in Missouri under the insurance laws of Chapter 379 RSMo (Insurance Other Than Life). A brief corporate history of the Company is summarized below.

- The Company was originally incorporated as Employers Indemnity Corporation and began business on July 1, 1914. The Company's offices were located in Kansas City, Missouri.
- The Company's name was changed to Employers Reinsurance Corporation on August 22, 1928.
- ERC became a subsidiary of ERC Corporation through an exchange of stock on July 25, 1969.
- Getty Oil Company purchased ERC Corporation in July 1980. The corporate headquarters were moved to Overland Park, Kansas in October 1980.
- ERC, ERC Corporation, and Getty Reinsurance Corporation were merged and the new entity was incorporated on March 13, 1981, as Getty Reinsurance Corporation. The Company name was concurrently changed to Employers Reinsurance Corporation. The ultimate parent remained Getty Oil Company.
- Getty Oil Company was acquired by Texaco, Inc. in February 1984.
- General Electric Capital Services, Inc. (GE Capital Services), a subsidiary of General Electric Company (GE), purchased all of the outstanding stock of ERC from Texaco, Inc. in July 1984.
- GE Capital Services contributed its ownership of ERC to a subsidiary holding company, GE Insurance Solutions Corporation (formerly GE Global Holding Corporation), in March 1995.

Capital Stock

The Company's Articles of Incorporation, effective December 31, 2003, allowed for the issuance of 1,000 shares of common stock with a par value of \$5,000 per share, 11,673 shares of Series A preferred stock with a par value of \$100,000 per share, and 700 shares of Series B preferred stock with a par value of \$100,000 per share. As of December 31, 2003, all 1,000 shares of common stock were issued and outstanding for a total common capital stock balance of \$5,000,000. As of December 31, 2003, all 11,673 shares of the Series A preferred stock were issued and outstanding and 275 shares of the Series B preferred stock were issued and outstanding for a total capital preferred stock balance of \$1,194,800,000. GE Insurance Solutions Corporation (GE Insurance Solutions) owns 100% of ERC's common stock. General Electric Capital Corporation owns 100% of the Series A preferred stock and Coregis Group, Inc. owns 100% of the Series B preferred stock.

The Articles of Incorporation specify that the voting rights of common stock are equal to one vote for each share. The Series A preferred stock is entitled to one one-hundredth (1/100) of a vote for each share. The Series B preferred stock is non-voting. Consequently, the common stockholders control 89.5% of the total votes and the Series A preferred stockholders control 10.5% of the total votes.

Dividends

The preferred stock accrues cumulative and preferred dividends at a rate of 7.50% for Series A and 5.00% for Series B. Cash dividends declared and paid to stockholders during each year of the examination period were as follows:

<u>Year</u>	<u>Common Stock</u>	<u>Series A Preferred Stock</u>	<u>Series B Preferred Stock</u>
2001	0	\$87,547,500	n/a
2002	\$253,085,360	87,547,500	\$ 875,000
2003	0	87,547,500	2,312,500

A non-cash dividend of \$226,101,584 was issued on the common stock held by GE Insurance Solutions in 2002 by transferring a collateralized receivable from Electric Mutual Liability Insurance Company, Ltd.

Management

The management of the Company is vested in a Board of Directors that are appointed by the shareholders. The Articles of Incorporation specify that the number of directors shall not be less than nine (9) and not more than twenty-five (25). All directors at the end of 2003 were employees of ERC. The Board of Directors appointed and serving, as of December 31, 2003*, were as follows:

<u>Name</u>	<u>Address</u>	<u>Position Held with ERC</u>
Ronald R. Pressman	New Canaan, Connecticut	Chairman of the Board, President and Chief Executive Officer
John W. Attey	Shawnee, Kansas	Senior Vice President - Claims, Secretary
Samira Barakat	Kansas City, Missouri	Senior Vice President - Risk Management
Jeanne K. Mason	Overland Park, Kansas	Senior Vice President - Human Resources
Marc A. Meiches	Leawood, Kansas	Executive Vice President and Chief Financial Officer
John C. Narvell	London, England	Senior Vice President and Chief Actuary
A. Louis Parker #	Overland Park, Kansas	Exec. Vice President - Commercial Insurance
Richard F. Smith	Minnetonka, Minnesota	Executive Vice President - P&C Reinsurance
Alfred J.V. Stanley #	Leawood, Kansas	Executive Vice President - Global Life & Health
William J. Steilen	Overland Park, Kansas	Senior Vice President – Global Treasury

* Mark E.M. Elborne was elected as a director effective March 1, 2004

A. Louis Parker and Alfred J.V. Stanley resigned effective June 17, 2004

Committees

The committees of the Board of Directors consist of an Executive Committee and an Investment Committee. These committees operate in accordance with the Company's Bylaws. The members of the committees as of December 31, 2003, were as follows:

<u>Executive Committee</u>	<u>Investment Committee</u>	
Ronald R. Pressman	Ronald R. Pressman	Richard F. Smith
Marc A. Meiches	Marc A. Meiches	Alfred J.V. Stanley
Richard F. Smith	Thomas A. Powers	Stephen DeVos
A. Louis Parker	Kieran Dempsey	Kathryn Karlic
	A. Louis Parker	Samira Barakat

Officers

The Board of Directors elect many Senior Vice Presidents, Vice Presidents, Second Vice Presidents, and Assistant Vice Presidents, which are too numerous to list in this report. The executive officers elected by the Board of Directors and serving as of December 31, 2003, were as follows:

Ronald R. Pressman	Chairman, President, and Chief Executive Officer
Marc A. Meiches	Exec. Vice President and Chief Financial Officer
A. Louis Parker#	Executive Vice President
Richard F. Smith	Executive Vice President
Alfred J.V. Stanley#	Executive Vice President
Kenneth J. Holferty	Treasurer
John W. Attey*	Secretary
Jeffrey D. Ayers	Assistant Secretary
Gregory F. Mischlich	Assistant Secretary
Ann Thompson	Assistant Secretary
John C. Narvell	Chief Actuary

* John W. Attey resigned as Secretary effective March 1, 2004.

Mark E.M. Elborne was elected Secretary, Executive Vice President and General Counsel effective March 1, 2004.

A. Louis Parker and Alfred J.V. Stanley resigned effective June 17, 2004

Conflict of Interest

The Company has a policy that requires all officers, directors, and key employees to complete a conflict of interest statement each year. Signed statements of officers and directors were reviewed for the examination period. No significant exceptions were noted.

Corporate Records

A review was made of the Articles of Incorporation and Bylaws for the examination period. The Articles of Incorporation were amended on September 4, 2002 to add a Series B preferred stock class with 700 authorized shares at \$100,000 par value per share. The Articles were amended and restated on March 14, 2005 to add an additional 269 shares of authorized common stock for a new total of 1,269 authorized shares. The Bylaws were amended on July 10, 2001 to change the required frequency of the Board of Directors' meetings from a quarterly basis to one annual meeting with the option for other meetings upon a Board resolution.

The minutes of the Board of Directors' meetings, committee meetings, and stockholders' meetings were reviewed for proper approval of corporate transactions. In general, the minutes appear to properly reflect and approve the Company's major transactions and events for the period under examination.

Acquisitions, Mergers and Major Corporate Events

Several intercompany transactions occurred in December 2002, which significantly changed the organizational structure of ERC and its subsidiary, ERC Life Reinsurance Corporation (ERC Life). These transactions effectively removed several European holding companies, insurance companies and reinsurance companies that were subsidiaries of ERC Life and placed them under a new subsidiary of ERC, GE Investments, Inc. (GE Investments). The transactions are described as follows:

- The ultimate parent, GE, purchased 180 shares of Class C common stock of a subsidiary, GE Investments, Inc. (GE Investments), for \$1,800,000,000.
- GE Investments contributed the \$1,800,000,000 proceeds from its stock sale to its newly created subsidiary, OP Holdings, Inc. (OP Holdings), by purchasing two shares of common stock.
- OP Holdings purchased 100% of GE Frankona Reinsurance Limited (located in the United Kingdom) and its subsidiaries from Employers Re Corporation (UK) Limited, a holding company and a subsidiary of ERC Life, for \$252,468,000. The subsidiaries of GE Frankona Reinsurance Limited included an insurance company and two reinsurers located in the United Kingdom and an insurance company in Bermuda.
- Employers Re Corporation (UK) Limited applied the cash that was received from OP Holdings to repay \$252,468,000 of principal balances due to ERC Life, pursuant to various loan notes.
- OP Holdings purchased 100% of GE Frankona Reinsurance Holding ApS, a Danish holding company, and its subsidiaries from ERC Life for \$1,464,311,000. The subsidiaries of GE Frankona Reinsurance Holding ApS included an insurance company in Denmark, a holding company and two insurance companies in France, and a holding company, two reinsurers and an insurance company in Germany.
- OP Holdings purchased 100% of Luxembourg European Reinsurance S.A. and its subsidiary, Irish European Reinsurance Company Limited, from ERC Life for \$83,221,000.
- The total cash received by ERC Life from the loan repayment from Employers Re Corporation (UK) Limited, the sale of GE Frankona Reinsurance Holding ApS and subsidiaries, and the sale of Luxembourg European Reinsurance S.A. and subsidiary, was \$1,800,000,000. ERC Life used the net cash proceeds from these three transactions to issue a \$1,800,000,000 dividend to ERC.
- GE contributed its 180 shares of GE Investments Class C common stock to ERC, which was reported to have a fair value of \$2,517,277,359.
- ERC purchased 30 shares of GE Investments Class C common stock for \$300,000,000.

As of December 31, 2002, ERC Life's remaining subsidiaries were Employers Re Corporation (UK) Limited, a holding company, and its subsidiary, GE Frankona Reassurance Limited, a reinsurer, both located in the United Kingdom.

On October 23, 2003, 100% of the common stock of Employers Re Corporation (UK) Limited and its subsidiary were transferred from ERC Life to ERC in the form of an extraordinary dividend valued at \$468,409,682. ERC simultaneously dividended 100% of the common stock of Employers Re Corporation (UK) Limited and its subsidiary to GE Insurance Solutions Corporation. On December 22, 2003, ERC sold 95% of its investment in ERC Life to Scottish Holdings, Inc., a subsidiary of Scottish Re Group Limited, an unaffiliated entity, for \$151,148,000.

Other events that affected the organizational structure of ERC are listed below.

- Effective July 1, 2002, the Company assumed 100% of the existing long-term care policies of American United Life Insurance Company (AUL) by entering into a reinsurance agreement. AUL transferred \$262,623,550 of liabilities to ERC for this block of business. ERC received a net payment of \$229,623,550 from AUL, which included a \$33,000,000 ceding commission.
- On May 16, 2002, the Company entered into a Deed of Assignment with GE Reinsurance Corporation (GE Re), an affiliate. This agreement transferred all of GE Re's direct insurance contracts in Australia to ERC. GE Re paid A\$41,000,000 to ERC as consideration for transferring the obligations of the Australian policies.
- Effective January 1, 2003, the Company entered into an Assumption Reinsurance Agreement with GE Re to transfer all of the reinsurance contracts from GE Re's Canadian branch to ERC. GE Re paid C\$46,551,000 to ERC as consideration for transferring the obligations of the Canadian contracts.
- On May 7, 2003, ERC entered into an assumption reinsurance agreement with CORE Insurance Company to assume all of its reinsurance agreements. All of CORE Insurance Company's reinsurance agreements were novated to ERC, effective December 31, 2003.
- On May 15, 2003, the Company executed a Stock Purchase Agreement to purchase CORE Insurance Company from CORE Reinsurance Company Limited for \$32,804,676. The Company could not locate a signed copy of this agreement. It was apparently lost or misplaced due to poor recordkeeping. Important corporate records such as agreements to purchase companies should not be lost or misplaced. The Company is directed to implement recordkeeping procedures to ensure that all significant agreements entered into by ERC are adequately maintained in its files.

Surplus Debentures

No surplus debentures were issued or outstanding for the period under examination.

AFFILIATED COMPANIES

Holding Company, Subsidiaries and Affiliates

The Company is a member of an Insurance Holding Company System as defined by Section 382.010, RSMo (Definitions). An Insurance Holding Company System Registration Statement was filed by ERC, on behalf of itself and its insurance subsidiaries, for each year of the examination period.

ERC is directly controlled by GE Insurance Solutions Corporation, which owns 100% of ERC's common stock. GE Insurance Solutions is a holding company that owns several other insurance and reinsurance companies.

The ultimate controlling entity of ERC is General Electric Company (GE), which is one of the largest organizations in the world. GE is a publicly traded stock company. GE consists of eleven operating segments, including GE Insurance Solutions. The other segments of GE are engaged in providing services or manufacturing in the following industries: commercial and consumer finance, aircraft engines and locomotives, energy industry technologies, consumer appliances, industrial lighting and electrical products, media and entertainment, plastics and advanced materials, power plant products, and medical technologies.

ERC owns numerous subsidiaries that are mostly insurance companies.

GE Investments is the largest subsidiary of ERC, based upon a reported fair value of \$2,100,083,377, as of December 31, 2003. There are several stock classes for GE Investments that are summarized below. None of the stock below is publicly traded.

<u>Stock Class</u>	<u>Ownership (All at 100%)</u>
Preferred A	Electric Research and Manufacturing Corporation, Inc.
Preferred A-1	General Electric Company
Preferred B	Scottish Re Life Corporation (formerly ERC Life)
Common A	General Electric Company
Common B	GE Capital Information Technologies, Inc.
Common C	ERC
Common D	General Electric Capital Corporation

The stock, dividend, voting, and liquidation rights of each stockholder class are defined in the Articles of Incorporation. Voting rights of one vote per share are allowed only for the common stock classes. As of December 31, 2003, General Electric Capital Corporation owned 4,000,000 or 99.97% of the total 4,001,283 issued and outstanding common stock shares of GE Investments. In comparison, ERC owned only 230 shares, as of December 31, 2003. GE is the ultimate controlling entity of GE Investments through its 100% ownership of General Electric Capital Corporation.

ERC, as the sole owner of the Class C common stock, is entitled to 3% annual, cumulative dividends on the original issue price of the Class C shares. The preferred stock Classes and Class B and D of the common stock also have stated dividend rates. The dividends received by ERC during the examination period are listed in a table in the Intercompany Transactions section of this report.

The Articles of Incorporation require an “Account” to be maintained for the Class B, C, and D common stock. The Account for each Class shall be determined as the sum of original issue price of the shares plus the net income earned on the specific assets dedicated to each Class, which are defined in the Articles, less cumulative dividends paid. The Class C Assets are the net assets of OP Holdings. The following table lists the organizations included in OP Holdings, as of December 31, 2003.

<u>Company</u>	<u>Jurisdiction</u>	<u>Ownership by OP Holdings</u>
GE Frankona Reinsurance Limited	United Kingdom	100%
GE Specialty Insurance (UK) Limited	United Kingdom	100%
ERC Frankona Reinsurance (II) Limited	United Kingdom	100%
ERC Frankona Reinsurance (III) Limited	United Kingdom	100%
Western Star Insurance Company Limited	Bermuda	100%
GE Frankona Capital, Ltd.	United Kingdom	100%
RGB Capital Holding, Ltd.	United Kingdom	100%
ES Reinsurance Group Services, Ltd.	United Kingdom	100%
Luxembourg European Reinsurance S.A.	Luxembourg	100%
GE ERC Strategic Reinsurance Limited	Ireland	23.75%
GE Re Management Services (Ireland)	Ireland	100%
GE Frankona Reinsurance Holding ApS	Denmark	100%
GE Frankona Reinsurance A/S	Denmark	100%
Protegys Group, S.A.	France	12.7%
Taitbout Finances II	France	74%
La Parisienne S.A.	France	98.91%
GE Frankona Reinsurance Holding GmbH	Germany	100%
GE Frankona Ruckversicherungs- Beteiligungsgesellschaft-Aktiengesellschaft	Germany	99%
GE Frankona Ruckversicherungs-Aktiengesellschaft	Germany	100%
Wurzbürger Versicherungs-Aktiengesellschaft	Germany	100%
GE Frankona Management Services GmbH	Germany	100%

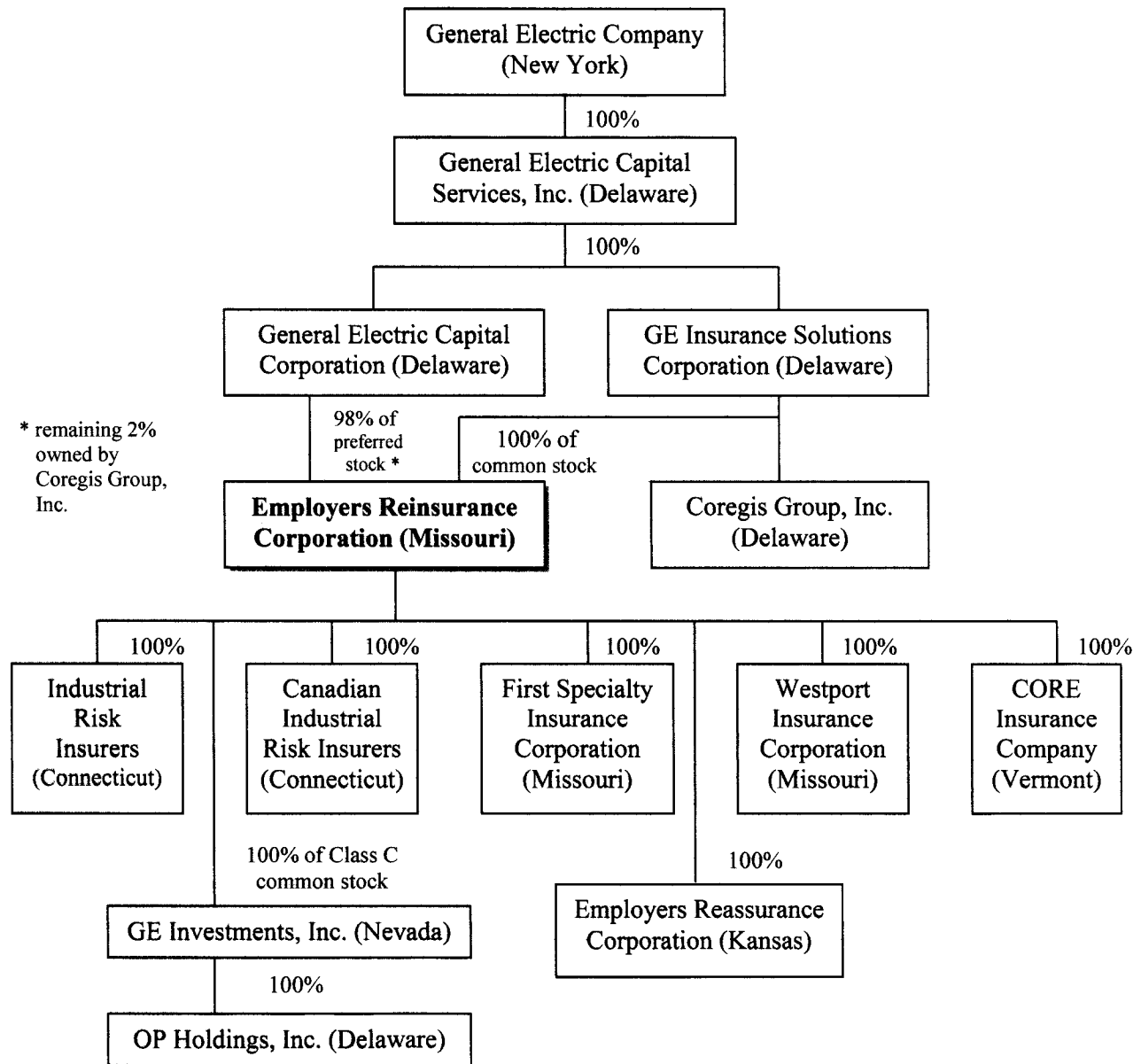
Upon liquidation, the Articles define that ERC would receive an amount equal to Class C Account plus the excess of the fair market value of the Class C Assets (OP Holdings) over the Class C Account. The balance of the Class C Account was \$3,017,114,860, as of December 31, 2003, and \$3,522,592,114, as of December 31, 2004. These amounts represent the minimum amount of funds that ERC would receive in the event of a liquidation of GE Investments. The fair market value of the Class C stock owned by ERC is unknown, since the stock is not publicly traded.

The other material subsidiaries of ERC are described below:

- Employers Reassurance Corporation (ERAC) is a life and health reinsurer.
- Westport Insurance Company (WIC) is a property and casualty insurer specializing in commercial lines of worker's compensation, lawyer's professional liability, general liability, property, crime, auto, and others.
- First Specialty Insurance Corporation (FSIC) is an excess and surplus lines insurer that specializes in commercial lines of wind and earthquake coverage, general liability, property, hospital professional liability, and lawyer's professional liability.
- Industrial Risk Insurers (IRI) is an voluntary joint underwriting association in which ERC has a 99.5% direct membership interest. WIC has the remaining 0.5% direct membership interest, but has an agreement that assigns that interest to ERC. IRI writes large property risks usually involving multiple locations.
- Canadian Industrial Risk Insurers (Canadian IRI) is also a voluntary joint underwriting association in which ERC has a 100% membership interest. Canadian IRI writes the same types of policies as IRI, but in Canada only.
- Core Insurance Company is a property and casualty reinsurer, but does not have any active operations. All of its reinsurance agreements were novated to ERC, effective December 31, 2003.

Organizational Chart

The following organizational chart depicts the ownership of ERC and the significant subsidiaries owned by ERC, as of December 31, 2003.



Intercompany Agreements

The Company's intercompany agreements in effect, as of December 31, 2003 and subsequent periods, are outlined below.

1. Type: Service Agreement

Affiliates: Westport Insurance Corporation, Employers Reassurance Corporation, GE Insurance Solutions Agency, LLC

Effective: February 27, 1986

Terms: ERC will provide office space, furniture and equipment and will provide the following services: data processing, accounting, financial, actuarial, legal, executive, personnel, payroll, sales, underwriting, claims and related services necessary to conduct the businesses of the named subsidiaries. Amendment No. 4, dated June 27, 1996, includes an exhibit that shows the calculation of allocated expenses for each affiliate. Allocation percentages are developed from methodologies, such as the number of employees and the amount of assets, to allocate the various types of expenses.

2. Type: Service Agreement

Affiliate: First Specialty Insurance Corporation

Effective: December 29, 1989

Terms: ERC will provide office space, furniture and equipment and will provide the following services: data processing, accounting, financial, actuarial, legal, executive, personnel, payroll, sales, underwriting, claims and related services necessary to conduct the business of FSIC. Amendment No. 1, dated June 26, 1996, includes an exhibit that shows the calculation of allocated expenses for each affiliate. Allocation percentages are developed from methodologies, such as the number of employees and the amount of assets, to allocate the various types of expenses.

3. Type: Guarantee (twelve separate guarantees with identical terms)

Affiliates: WIC, ERAC, GE Reinsurance Corporation (GE Re), Luxembourg European Reinsurance S.A., GE ERC Strategic Reinsurance Limited, GE Frankona Reassurance Limited, GE Frankona Reinsurance Limited, GE Specialty Insurance (UK) Limited, GE Frankona Reinsurance A/S, GE Frankona Reinsurance, Ltd., UK, GE Frankona Ruckversicherungs-Aktiengesellschaft (GE Frankona Re), Coregis Insurance Company

Effective: January 1, 2000 for GE Specialty Insurance (UK) Limited, January 1, 2000 for GE Frankona Re, November 17, 2003 for Coregis Insurance Company, and August 27, 1996 for all other affiliates

- Terms:** Upon default by any of the affiliates, ERC guarantees to make payments due under any contract of insurance (applicable to GE Specialty Insurance (UK) Limited and Coregis Insurance Company) or reinsurance (applicable to all other affiliates) issued by the affiliates.
- 4. Type:** Master Services Agreement
- Affiliate:** GE Capital Fleet Services
- Effective:** March 9, 1998
- Terms:** GE Capital Fleet Services provides various services related to the vehicles used by ERC. Addendums to the Master Services Agreement define each service to be provided. These services include an accident prevention program, preparing and issuing insurance cards, vehicle maintenance management, and fleet management. ERC will pay fees for each service based on a per vehicle rate or other per unit basis, as defined in each Addendum.
- 5. Type:** Master Cost Allocation Agreement
- Affiliates:** ERC Asia Pacific Pte Ltd (ERC Asia Pacific), ERC Frankona Ruckversicherungs AG, ERC Frankona Reinsurance A/S, ERC Frankona Reinsurance Ltd.
- Effective:** September 30, 1998
- Terms:** ERC Asia Pacific will provide services to conduct each entity's business in the Asia-Pacific region. The services include the following: data processing and computer services, investment, internal audit, actuarial, legal, tax, branch support, cash management, group controlling, financial planning and analysis, personnel, payroll, underwriting, claims and related services. ERC Asia Pacific will be reimbursed for its actual direct and indirect costs incurred to provide the services plus a 5% markup.
- 6. Type:** Master Outsourcing Agreement
- Affiliates:** GE Insurance Solutions Corporation, GECIS, FSIC, WIC, ERAC, GE Insurance Solutions Agency, LLC (GEISA), Industrial Risk Insurers (IRI), The Medical Protective Company (Med Pro), GE Re, Coregis Insurance Company, California Insurance Company, Coregis Indemnity Company
- Effective:** March 1, 1999
- Terms:** GECIS will provide the following business outsourcing services for the affiliates: data processing, administrative, actuarial, general accounting, treasury, financial reporting, technical accounting, filing approval notices, agents licensing, claims, underwriting, and other support services. GECIS shall prepare reports relating to performance of the services as reasonably requested. This agreement will be supplemented for each service to be provided by a specific Statement of Work (SOW) to establish in writing the scope of the services, performance standards, pricing and customer provided support for each project. The fees for the services

provided shall be agreed to by the parties and incorporated within the individual SOWs.

A summary of the SOWs attached to this agreement in which ERC is a named party is listed in the table below.

SOW No.	Effective Date	Services Provided by GECIS
1	July 1, 2000	Processes for reporting to the Insurance Services Office and state motor vehicle departments
2	May 1, 2000	Claims and underwriting support services
3	May 1, 2000	Cash allocation processes for receipts and disbursements
3a	May 1, 2000	Prepare 1099 forms to be sent to the Internal Revenue Service, payees, and states
3b	May 1, 2000	Prepare general ledger and bank reconciliations
3c	May 1, 2000	Prepare and file escheatment reports with various states
4	March 1, 1999	Claims services and policy coverage determination for provider excess and medical stop loss policies
5	April 1, 2000	Profitability and financial analysis
6	September 1, 2000	Cash allocation processes for reinsurance business
7	November 30, 2000	Data entry for filings with rate service organizations
10	September 1, 2000	Record client reported data on the operating system
12	March 21, 2001	Actuarial analysis and support processes
14	August 17, 2001	Claim file management on the treaty system
15	September 6, 2001	Claim file management for accident and health policies
16	September 1, 2001	Reinsurance transaction processing and reporting
17	October 26, 2001	General ledger account reconciliations
18	October 26, 2001	Accounting for receipts, disbursements, cash balancing
19	October 1, 2001	Claims and underwriting support services
20	October 1, 2001	Data analysis for property and casualty reinsurance
21	June 1, 2000	Catastrophe exposure analysis and modeling
22	October 31, 2001	Agent receivable reconciliations and collections
23	December 5, 2001	Retrocession accounting and billing
24	March 1, 2000	Planning, leading, and completing quality projects
26	December 18, 2001	Claim processing for hospital professional liability line
27	December 20, 2001	Claim processing for excess worker's compensation line
29	December 20, 2001	Perform human resources functions
32	February 20, 2002	Research, analysis, modeling for risk factors in the business operations
35	November 22, 2002	Pricing modeling, business portfolio analysis
38	June 30, 2003	Data entry for customer data, contract issuance
41	January 23, 2004	Pricing, underwriting, binding, and issuance of policies
42	October 12, 2004	Implement a common financial reporting platform
43	September 12, 2004	Scheduling services, customer service center monitoring
44	September 21, 2004	Contract administration, corporate and regulatory support

7. **Type:** Service Mark Agreement
Affiliate: GE Insurance Solutions Corporation
Effective: January 1, 2000
Terms: GE Insurance Solutions has the right from GE to license the use of the GE logo and other licensed marks. GE Insurance Solutions grants a license to ERC to use the GE logo and other licensed marks. ERC will pay an annual royalty of 0.125% of its total assets, as stated in its GAAP financial statements.
Exception: This Agreement was never filed for prior approval with the MDI, as required by Section 382.195 RSMo. (Transactions Within a Holding Company System). The Company is directed to immediately submit this Agreement as part of a Form D filing to the MDI for approval. Payments made by ERC under this Agreement should cease until the Agreement is approved by the MDI.

8. **Type:** Computer Services Agreement
Affiliates: General Electric Company, FSIC, WIC, ERAC
Effective: November 4, 2000
Terms: General Electric Company, acting through its Global Computer Operation Division (GCO), will provide the following computer services: operations, production control, technical services, database administration, data center / network disaster recovery, service level performance, and logical access control. Fees to be paid to GCO by ERC and its subsidiaries are based upon scheduled amounts listed in the agreement.

9. **Type:** Federal Tax Allocation Agreement
Affiliates: GE Insurance Solutions Corporation, WIC, FSIC, IRI Management Services, LLC, IRI Corporation, IRI Holdings
Effective: January 1, 2001
Terms: ERC and all other entities in the agreement are included in the consolidated tax return filed by General Electric Company. The federal tax liability of each affiliate shall be calculated on a separate return basis. The subsidiaries of ERC will remit tax payments to ERC. ERC then remits tax payments on behalf of itself and its subsidiaries to GE Insurance Solutions.
Exception: There were federal income tax settlements during the examination period between the Company and several affiliates that were not parties to the Federal Tax Allocation Agreement. The affiliates were Med Pro, Coregis Group, Inc., CORE Insurance Holdings, GE Re, GE Reinsurance (Bermuda) Limited, and OP Holdings, Inc. The Company is directed to amend the Agreement to add these affiliates. Such amendment should be submitted to the MDI for prior approval, as part of a Form D filing.

10. Type: Claims Administration Agreement**Affiliate:** GE Reinsurance Corporation**Effective:** January 1, 2001

Terms: ERC is appointed as a claims administrator and in that capacity ERC shall adjust and settle claims on the business of GE Re for all claims of less than \$1,000,000. ERC will act on behalf of GE Re in all matters relating to the handling and disposition of claims. Any claims of \$1,000,000 or more will be referred to GE Re for special instructions and coordination. Claim files of GE Re will be maintained in ERC's offices. GE Re will pay ERC an annual fee as agreed upon by the parties, but the fee shall not be less than ERC's costs to provide the services specified in the agreement.

11. Type: Master Managed Services Agreement**Affiliates:** GE IT Solutions, Inc. (GEITS), General Electric Company and its affiliates (including ERC)**Effective:** January 10, 2001

Terms: GEITS provides outsourced computer helpdesk support services. This agreement defines the standard contract terms and will be supplemented for each service to be provided by a specific Scope of Work (SOW). The fees for the services provided shall be agreed to by the parties and incorporated within the individual SOWs.

A summary of the SOWs attached to this agreement in which ERC is a named party is listed in the table below.

SOW No.	Effective Date	Services Provided by GEITS
1	December 26, 2000	Respond to technical problems from user requests
2	April 24, 2001	Installation, maintenance, support for personal computers
4	April 23, 2004	Maintenance of UNIX systems and database servers
5	April 23, 2004	Data security and server systems administration
6	April 23, 2004	Administration of asset management systems
7	April 23, 2004	Technical support for computer systems
9	June 21, 2004	On-site help desk support management
10	June 21, 2004	End-user deskside support coordination

- 12. Type:** Service Agreement
- Affiliate:** Industrial Risk Insurers
- Effective:** March 26, 2001
- Terms:** ERC will provide equipment and will provide the following services: data processing and computer services, accounting, financial, actuarial, executive, personnel, sales, underwriting, claims and related services necessary to conduct the business of IRI. IRI will reimburse ERC for its actual and/or budgeted expenses incurred in providing the services based upon a proportionate percentage of annual overhead, salary and expenses.
- 13. Type:** Cost Sharing and General Services Agreement
- Affiliate:** The Medical Protective Company
- Effective:** August 21, 2001
- Terms:** ERC will provide equipment and will provide the following services: data processing, accounting, financial, actuarial, executive, personnel, sales, underwriting, claims and related services necessary to conduct the business of Med Pro. Med Pro will reimburse ERC for its actual and/or budgeted expenses incurred in providing the services based upon a proportionate percentage of annual overhead, salary and expenses.
- 14. Type:** Service Agreement
- Affiliates:** CORE Insurance Holdings, Inc. (CORE Holdings) and its subsidiaries, Core Reinsurance Company Limited (CORE Re), CORE Insurance Company (CORE Insurance), CORE Managers, Inc.
- Effective:** November 15, 2001
- Terms:** ERC will provide equipment and will provide the following services: data processing and computer services, accounting, financial, actuarial, executive, personnel, payroll, sales, underwriting, claims and related services necessary to conduct the business of the affiliates. CORE Holdings and its subsidiaries will pay ERC the proportionate share of actual direct and indirect expenses required by ERC personnel to perform the services.
- 15. Type:** Investment Management and Services Agreement
- Affiliates:** GE Asset Management Incorporated (GEAM), WIC, FSIC
- Effective:** May 1, 2002
- Terms:** GEAM will provide investment management services. The services will include research and identify investment opportunities, assist in developing an overall investment strategy, invest and sell assets in accordance with applicable laws and the investment guidelines of each entity, prepare quarterly reports of the

purchases and sales of investments and present such reports to the Board of Directors or Investment Committee, and other services. ERC, WIC, and FSIC will pay GEAM a quarterly management fee equal to 0.053% of the value of the assets managed by GEAM.

16. Type: Services Agreement

Affiliates: GE Reinsurance Corporation, WIC

Effective: September 16, 2002

Terms: ERC will provide equipment and will provide the following services: data processing, accounting, financial, actuarial, executive, personnel, sales, underwriting, claims and related services necessary to conduct the business of GE Re. GE Re will reimburse ERC for its actual and/or budgeted expenses incurred in providing the services based upon a proportionate percentage of annual overhead, salary and expenses. GE Re will also provide the same services (excluding executive) for ERC and WIC and will be reimbursed using the same methodology in which GE Re reimburses ERC.

17. Type: Consulting Agreement

Affiliates: iProcess International, LLC (iProcess), WIC, FSIC, ERAC, Med Pro, GE Re, Coregis Insurance Company

Effective: December 26, 2002

Terms: iProcess will provide the following consulting services: recommendations for improving and standardizing processes, resolving issues outside of standard operating procedures, forecasting operational needs, formulating and implementing outsourcing programs, obtaining outsourcing services, training personnel, and other services. ERC will reimburse iProcess for all of its reasonable costs incurred, including salaries and travel and living expenses, in providing the services for all entities. The other affiliates will reimburse ERC for each entity's applicable portion of the total costs paid by ERC.

18. Type: Master Equipment Lease Agreement

Affiliate: General Electric Capital Corporation

Effective: January 1, 2003 to December 31, 2005

Terms: ERC will lease various equipment from General Electric Capital Corporation that will be used to issue employee security badges and for monitoring physical access to corporate facilities. Monthly lease payments paid by ERC are \$4,153.

19. Type: Cost Sharing and General Services Agreement

Affiliates: Coregis Insurance Company (Coregis) and Coregis Group, Inc. (Coregis Group)

Effective: January 1, 2003

Terms: ERC will provide equipment and will provide the following services: data processing, accounting, financial, actuarial, executive, personnel, sales, underwriting, claims and related services necessary to conduct the business of Coregis and Coregis Group. Coregis and Coregis Group will reimburse ERC for its reasonable and necessary expenses incurred in providing the services based upon a proportionate percentage of annual overhead, salary and expenses. Exhibit A-1 of the Agreement shows the allocation methodology and allocation amounts for the various types of services provided for Coregis and Coregis Group.

20. Type: Shared Offices Facilities Agreement

Affiliates: GE Card Services, Inc., (GE Card Services) General Electric Capital Assurance Company, GE Capital Commercial Finance, Inc., GE Capital Healthcare Financial Services, Inc., Gelco Corporation

Effective: January 1, 2003

Terms: GE Card Services, Inc. will lease a building in Frisco, Texas that will be used for office space by various GE affiliates. ERC's space will be used by IRI to support operations in the Dallas/Ft. Worth area. Each party to the agreement will be responsible for sharing the rent, operating expenses, office services expenses, and other expenses associated with operating the building and its equipment. Most of the expenses will be allocated to each entity based upon the square footage leased by each entity.

21. Type: Parental Guarantee

Affiliate: First Specialty

Effective: June 30, 2003

Terms: ERC guarantees to reimburse First Specialty for 100% of any recoverables that are due to First Specialty under a reinsurance agreement from an external reinsurer, in the event that such recoverables become uncollectible. The Guarantee applies to all past, current, and future reinsurance agreements of the Company. ERC was paid \$10,000 from First Specialty as consideration for the Guarantee.

- 22. Type:** Marketing Network Master Services Agreement
Affiliate: GE Marketing Network
Effective: May 13, 2003 to December 31, 2004
Terms: GE Marketing Network will provide online seminars and provide services to coordinate the seminars. ERC will pay no more than \$2,000 per seminar.
- 23. Type:** Sublease Agreement
Affiliate: General Electric Capital Corporation
Effective: June 1, 2003 to October 31, 2009
Terms: ERC leases approximately 21,700 square feet of office space in a building in Philadelphia, Pennsylvania. GE Capital Corporation will sublease approximately 7,800 square feet of this office space from ERC. The rental payments to be paid to ERC each year are scheduled in the agreement beginning at \$7,184 at the inception and ending at \$11,068 in 2009.
- 24. Type:** Memorandum of Agreement
Affiliate: GE Capital International Services, Inc.
Effective: September 23, 2003 to March 23, 2004
Terms: GECIS will provide business continuity planning services for ERC's computer systems. Compensation paid shall not exceed \$45,000 in total.
- 25. Type:** Guarantee
Affiliate: GE Insurance Solutions Corporation
Effective: December 30, 2003
Terms: GE Insurance Solutions agrees to pay ERC any amounts due from unauthorized reinsurers, as identified on Schedule F – Part 5 of the Annual Statement, in the event that the unauthorized reinsurers default on their obligations to ERC. The Guarantee is to be secured by a letter of credit naming ERC as the beneficiary.
- 26. Type:** Sublease
Affiliate: GE Dental and Vision
Effective: January 1, 2004 to May 15, 2005
Terms: GE Dental and Vision leases office space in a building in Agoura Hills, California. ERC will sublease approximately 400 square feet of this office space from GE Dental and Vision. The rental payments to be paid by ERC for the term of the lease will be \$733 per month.

27. Type: Claims Administration Agreement

Affiliate: CORE Reinsurance Company Limited

Effective: January 1, 2004

Terms: ERC is appointed as a claims administrator and in that capacity ERC shall adjust and settle claims on the business of CORE Re for all claims of less than \$1,000,000. ERC will act on behalf of CORE Re in all matters relating to the handling and disposition of claims. Any claims of \$1,000,000 or more will be referred to CORE Re for special instructions and coordination. Claim files will be maintained in ERC's offices. CORE Re will pay ERC an initial annual fee of \$225,000. Each year the volume of claims processed will be evaluated and the fee may be adjusted based upon a formula in the agreement. The fee shall not be less than ERC's costs to provide the services specified in the agreement.

28. Type: Service Reimbursement Agreement

Affiliates: General Electric Company, WIC, FSIC, GE Re

Effective: April 8, 2004

Terms: The Global Business Services (GBS) division of GE will provide the following services: payroll, employee benefits, travel and living, and other services. ERC employees will participate in the GE Pension Plan and other GE benefit plans pursuant to this agreement. ERC will pay GBS for the direct costs attributable to its employees and an allocated amount for costs that are not directly attributable. ERC's allocated share is based upon the total annual compensation of ERC employees compared to the total for all GE employees. WIC, FSIC, and GE Re will reimburse ERC for each entity's respective actual or proportional share of the total costs paid by ERC.

29. Type: Statement of Work No. 1, pursuant to a Managed Security Services Master Agreement (Master Agreement)

Affiliate: GE IT Solutions

Effective: Effective when signed by ERC and 28 months thereafter

Terms: ERC's parent, GE, has a Master Agreement with GE IT Solutions. ERC is not a party to that agreement. However, ERC is a party to the Statement of Work (SOW) No. 1, which incorporates all terms and conditions of the Master Agreement. Under the terms of SOW No. 1, GE IT Solutions will provide managed security services for ERC's computer equipment. ERC will pay \$1,482 per month to GE IT Solutions for the services provided.

- 30. Type:** Capital Maintenance Agreement
- Affiliate:** General Electric Capital Corporation (GE Capital Corporation)
- Effective:** December 31, 2005 (dated March 31, 2005)
- Terms:** GE Capital Corporation agrees to make capital contributions to ERC in the amount required to maintain an A.M. Best Company, Inc. (A.M. Best) Capital Adequacy Ratio (BCAR) of 175%. The Agreement has several termination provisions. The Agreement may be terminated (1) if ERC is no longer a direct or indirect subsidiary of GE, or (2) A.M. Best issues a rating to ERC of “A (Excellent)” with a “Stable” outlook, or (3) when there is a replacement for this Agreement approved in writing by A.M. Best, or (4) after December 31, 2007 with one year notice in writing to ERC and A.M. Best.

In addition to the above listed agreements, ERC has reinsurance agreements with several of its subsidiaries, which are described in the Reinsurance section of this report.

The Company could not provide signed agreements for the following agreements, listed above: (1) Consulting Agreement with iProcess and other affiliates, (2) SOW No. 1 under the Managed Security Services Master Agreement with GE IT Solutions, Inc., (3) Services Agreement with GE Re, (4) SOW No. 4 under the Master Managed Services Master Agreement with GE IT Solutions, Inc. Therefore, these agreements were apparently never formally executed since they were not signed by the parties. The Company is directed to immediately execute these agreements and cease all transactions until the agreements are executed.

Intercompany Transactions

ERC had numerous transactions with its parent companies, subsidiaries, and affiliates during the examination period. Several significant transactions that affected the organizational structure were previously described in the Acquisitions, Mergers, and Major Corporate Events section of this report. Other transactions are as follows:

- On September 26, 2001, ERC received a non-cash capital contribution of \$181,101,584 from GE. The contribution was in the form of an assigned receivable from Electric Mutual Liability Insurance Company, Ltd. (EMLICO). The receivable had a face value of \$226,101,584 less a \$45,000,000 valuation allowance to derive the \$181,101,584 book value recorded by ERC.
- On September 19, 2002, the Company received \$70,000,000 from Coregis Group for the issuance of all 700 shares of ERC's Series B preferred stock, with a par value of \$100,000 per share.
- On December 12, 2002, the Company paid a non-cash dividend of \$226,101,584 to GE Insurance Solutions. The dividend was in the form of transferring the EMLICO receivable that had been assigned to ERC on September 26, 2001, as described above.

- On December 17, 2002, the Company contributed its 41.5% investment in CORE Insurance Holdings, Inc. of \$17,231,883 to GE Insurance Solutions.
- On December 27, 2002, the Company paid \$20,000,000 to Coregis Group to redeem 200 shares of its Series B preferred stock.
- On May 7, 2003, the Company entered into an assumption reinsurance agreement with Core Insurance to assume all of the rights and obligations from its insurance contracts and reinsurance agreements. Effective December 31, 2003, all of CORE Insurance's insurance contracts and reinsurance agreements were novated to ERC.
- On July 23, 2003, the Company paid \$200,000,000 to GE Investments to purchase 20 shares of its Class C common stock.
- On October 16, 2003, the Company paid \$22,500,000 to Coregis Group to redeem 225 shares of its Series B preferred stock.

The following table summarizes the cash dividend payments and capital contributions during the examination period.

Related Party	Payment Type	Amount Paid / (Received) by ERC		
		2001	2002	2003
GE Capital Corporation	Dividend	\$ 87,547,500	\$ 87,547,500	\$ 87,547,500
GE Capital Services	Dividend	(21,087,500)	(19,575,000)	(20,250,000)
GE Capital Services	Capital Cont.	(400,000,000)	0	0
GE Global Asset Protection Serv.	Capital Cont.	0	12,387,000	0
GE Frankona Re	Capital Cont.	0	100,000,000	0
ERC Life	Capital Cont.		(1,800,000,000)	(151,000,000)
FSIC	Capital Cont.	0	25,000,000	0
WIC	Capital Cont.	0	130,000,000	0
GE Frankona Reassurance Ltd.	Capital Cont.	0	85,525,000	0
GE Insurance Solutions	Dividend	0	253,085,360	0
Coregis Group	Dividend	0	875,000	2,312,500
Employers Re Corp. (UK) Ltd.	Capital Cont.	0	103,597,000	0
GE Investments	Dividend	0	0	(63,700,000)
TOTAL		(\$333,540,000)	(\$1,021,558,140)	(\$145,090,000)

The following table summarizes the payments made during the exam period, between ERC and its affiliates, pursuant to intercompany agreements.

Related Party	Agreement	Net Amount Paid / (Received) by ERC		
		2001	2002	2003
WIC	Service	(15,087,201)	(12,002,212)	(13,390,706)
ERAC	Service	(7,439,673)	(7,218,186)	(7,725,560)
ERC Life	Service	(5,466,023)	(4,464,832)	(4,836,020)
FSIC	Service	(3,114,641)	(3,067,718)	(3,627,913)
Med Pro	Cost Sharing	(8,076,123)	(9,059,019)	(12,903,610)
IRI	Service	(7,580,759)	(3,438,406)	(4,457,575)
CORE Insurance	Service	0	0	(215,089)
GE Re	Service	(7,782,628)	(6,219,548)	(7,024,752)
GE Re	Claims Administration	(75,000)	0	0
Coregis Insurance	Cost Sharing	(6,418,014)	(5,962,579)	(5,877,661)
GE	Computer Services	4,316,000	4,020,000	3,801,426
GE	Service Reimbursement	88,010,600	139,173,714	179,649,270
GE Capital Corp.	Federal Tax Allocation	(306,892,001)	(732,263,061)	(55,361,000)
CORE Holdings	Federal Tax Allocation	6,757,392	(454,340)	(875,000)
GE Re	Federal Tax Allocation	62,532,511	182,336,743	51,256,524
GE Re (Bermuda)	Federal Tax Allocation	0	0	(2,627,782)
Med Pro	Federal Tax Allocation	(20,695,644)	6,850,656	(20,345,740)
FSIC	Federal Tax Allocation	(4,055,988)	(4,442,611)	1,711,644
WIC	Federal Tax Allocation	(3,565,999)	33,321,961	11,832,070
Coregis Group, Inc.	Federal Tax Allocation	24,577,785	26,161,527	10,143,621
GE Insur. Solutions	Federal Tax Allocation	55,557,343	60,957,088	50,467,028
OP Holdings, Inc.	Federal Tax Allocation	0	(7,711,550)	51,559,764
GE Insur. Solutions	Service Mark	6,587,721	11,957,140	15,905,167
GECIS-Americas, Inc.	Service	292,822	0	0
GECIS	Various SOWs	1,830,713	2,450,926	4,046,882
Ddemesis S.A.	Task Order	0	109,740	0
GEAM	Investment Management	0	2,570,659	4,747,476
ERC Asia Pacific	Cost Allocation	0	0	2,548,767
GEITS	Service	0	25,000	2,454,929
GE Capital Corp.	Master Equipment Lease	0	0	1,213,331
Birlasoft, Inc.	Task Orders	0	500,000	1,270,254
GE Card Services	Shared Office Facilities	0	2,225	0
GE Insur. Solutions	None – see below	(59,340,152)	(69,054,602)	(82,010,871)
GE GAPS	None – see below	0	(4,262,104)	(3,212,624)
TOTAL		(\$205,126,959)	(\$399,183,389)	\$168,116,250

The Company also had other intercompany transactions that were not subject to any written agreement. Most of the transactions appeared to be for the sharing of joint expenses. The transactions were recorded in ERC's general ledger in various intercompany accounts with ERC Long Term Care Solutions, Inc., GE Insurance Solutions Corporation, GE Global Asset Protection Services, LLC (GE GAPS), and several subsidiaries of OP Holdings. Payments to GE Insurance Solutions Corporation and GE GAPS are listed in the table above. Amounts paid to or received from ERC Long Term Care Solutions, Inc. and the subsidiaries of OP Holdings could not be provided by the Company. The Company is directed to draft written agreements for the transactions that are occurring with these affiliates. The proposed agreements should be submitted in a Form D filing for prior approval with the MDI, as required by Section 382.195 RSMo (Transactions Within a Holding Company System). The Company is further directed to cease transactions with these affiliates until agreements are approved by the MDI and signed by all parties.

Some intercompany transactions were not properly reported on Schedule Y – Part 2 of the Annual Statement. All payments made or received for the Master Cost Allocation Agreement with ERC Asia Pacific, the Service Reimbursement Agreement with GE, and the Service Mark Agreement with GE Insurance Solutions Corporation were improperly omitted. Transactions that occurred without an underlying written agreement, as identified in the preceding paragraph, were not reported on Schedule Y – Part 2. Also, ERC's purchase of GEI stock for \$300,000,000 in 2002 was another transaction not reported. The Company is directed to implement accounting procedures to track all transactions with affiliates and subsidiaries to ensure the complete reporting of these transactions on Schedule Y – Part 2.

FIDELITY BOND AND OTHER INSURANCE

As of the December 31, 2003, the Company's ultimate parent, GE, self-insured the first \$25,000,000 of fidelity insurance coverage for itself and all of its subsidiaries, including ERC. GE also had a crime insurance policy that provided fidelity coverage for all subsidiaries, including ERC, which had a liability limit of \$125,000,000 and a \$25,000,000 deductible. In June 2005, the self-insured portion of GE's crime insurance policy was reduced to \$10,000,000. The Company stated that there is no agreement with GE or any internal procedures whatsoever to define ERC's financial responsibility in the event that ERC should incur a fidelity loss. It appears that ERC would have a \$10,000,000 deductible for any fidelity loss. The suggested minimum level of coverage for ERC, according to NAIC guidelines, is \$4,500,000 based upon admitted assets and premiums. Although a \$10,000,000 deductible exceeds the NAIC suggested minimum coverage, this amount is not materially deficient, considering ERC's level of capital and surplus.

GE is also a named insured on several other insurance policies. Although ERC is not specifically named as an insured on most of these policies, the terms define coverage as being applicable to all subsidiaries of GE, which would include ERC. These additional insurance policies are as follows: property, commercial general liability, commercial umbrella liability, workers compensation, employers' liability, employment practices liability, fiduciary liability, directors' and officers' liability, errors and omissions liability, and business auto.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

ERC had a total of 1,194 employees, as of May 2005. There were 249 employees in the corporate headquarters, located in Kansas City, Missouri, and 551 employees in the home office building in Overland Park, Kansas. Direct business and reinsurance accounts are also serviced from branch offices in the United States that had 320 employees. The U.S. branch offices are located in Atlanta, Boston, Charlotte, Chicago, Columbus, Coral Gables, Dallas, Denver, Detroit, Hartford, Los Angeles, New York, Philadelphia, San Francisco, Seattle, and Toronto. ERC also had 74 employees that services international accounts in foreign branch offices in Australia, Canada, Germany, Great Britain, Indonesia, and New Zealand.

ERC has also outsourced a number of its functions to other entities. The management of its investment portfolio is performed by an affiliate, GE Asset Management Incorporated (GEAM). The investment accounting function is outsourced to State Street Bank and Trust Company (State Street), an unaffiliated entity. State Street is responsible for reconciling investment accounts to the G/L balances and preparing all statutory reports for investments such as Schedule D, DA, BA, and E - Part 2 of the Annual Statement. GECIS, an affiliate located in India, performs various services that include accounting, actuarial, claims, data entry, financial analysis, underwriting, and several other services. GEITS, also an affiliate located in India, provides the administration and maintenance of computer systems, and technical support for ERC employees. Refer to the Intercompany Agreements and Intercompany Transactions sections of this report for a review of all affiliated agreements and transactions.

Benefits provided to ERC employees include health insurance, dental insurance, vision insurance, disability insurance, long-term care insurance, life insurance, medical and child care flexible spending accounts, and a 401(k) savings plan with matching contributions. All employees are covered by two separate defined benefit pension plans. Those employees vested prior to October 1, 1999 are covered by the ERC Retirement Plan, while those employees vested on or after October 1, 1999 are covered by the General Electric Pension Plan. The benefits vary between the two pension plans. Post-retirement benefits are also provided to retirees.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Missouri Department of Insurance, as of December 31, 2003, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with Section 379.098 RSMo (Securities Deposit). The funds on deposit as of December 31, 2003, were as follows:

<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
State and Municipal Bonds	\$4,345,000	\$4,421,824	\$4,421,824

Deposits with Other States and Countries

The Company also has funds on deposit with other states, Canada, and New Zealand. Those funds on deposit as of December 31, 2003, were as follows:

<u>State, Territory, or Country</u>	<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
Arizona	Municipal Bonds	\$8,015,000	\$8,040,856	\$8,040,856
Arkansas	Municipal Bonds	350,000	343,328	343,328
California	Municipal Bonds	271,155,000	281,720,973	279,681,709
Canada	Bonds	711,042,820	750,373,593	750,373,593
Delaware	U.S. Treasury Bond	15,000	17,977	14,669
Georgia	Municipal Bonds	210,000	215,030	215,030
Louisiana	Municipal Bonds	100,000	94,991	94,991
Massachusetts	Municipal Bonds	500,000	507,348	507,348
New Mexico	Municipal Bonds	395,000	423,745	423,745
New Zealand	Government Bond	500,000	519,211	519,211
North Carolina	Municipal Bonds	320,000	132,882	132,882
Oklahoma	Municipal Bonds	375,000	370,299	370,299
Oregon	Municipal Bonds	5,585,000	5,908,143	5,845,949
Virginia	U.S. Treasury Bond	400,000	453,314	453,314
Total		<u>\$998,962,820</u>	<u>\$1,049,121,690</u>	<u>\$1,047,016,924</u>

Other Deposits

The Company is the grantor in a Trust Agreement, dated July 1, 2002, with American United Life Insurance Company (AULIC) as the named beneficiary. The Company is also the grantor in a Trust Agreement, dated August 28, 2003, with United National Insurance Company (UNIC). The Trust Agreements with AULIC and UNIC were established pursuant to reinsurance agreements between ERC and these entities for the purpose of securing assets of ERC to cover its obligations for assumed claims and loss reserves. ERC's assets in the trusts are maintained in a separate bank accounts. The trust funds on deposit as of December 31, 2003, were as follows:

<u>Trust Account Beneficiary</u>	<u>Type of Securities</u>	<u>Par Value</u>	<u>Market Value</u>
AULIC	Corporate Bonds	\$264,440,000	\$311,050,620
UNIC	Corporate and Government Bonds	159,349,000	155,447,489
Total		<u>\$423,789,000</u>	<u>\$466,498,109</u>

The NAIC Annual Statement Instructions require disclosure of assets in trust accounts, since these assets are not for the benefit of all policyholders, claimants, and creditors of the Company. The Company is directed to report trust account assets with AULIC and UNIC on Schedule E – Part 3 – Special Deposits of the Annual Statement in the future.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

ERC is licensed as a property and casualty insurer by the Missouri Department of Insurance under Chapter 379 RSMo (Insurance Other than Life). The Company is licensed and writes business in all fifty states and the District of Columbia. The Company is also licensed in the U.S. territories of Guam and Puerto Rico, ten provinces of Canada, and nationally in Canada and Australia.

Written premiums in Canada and Australia accounted for 26.0% and 23.9%, respectively, of the total direct written premiums in 2003. The largest percentages of premium written in the United States were in California (4.9%) and Indiana (4.6%).

ERC is primarily a reinsurer with limited direct business. Assumed premiums represented 88.8% and direct premiums represented only 11.2% of the total direct and assumed premiums for 2003. The major lines of direct business, based upon 2003 direct written premiums, are as follows:

<u>Line of Business</u>	<u>Percentage of Direct Written Premiums</u>
Group Accident and Health	31.0%
Other Liability – Occurrence	21.3%
Excess Worker's Compensation	14.4%
Other Liability – Claims Made	13.0%
All Other	<u>18.2%</u>
Total	100.0%

The Company, its subsidiaries, and other affiliated insurance companies are managed as “GE Insurance Solutions.” There are three main profit and loss (P&L) centers of GE Insurance Solutions, as follows: (1) Global Life and Health, (2) P&C Reinsurance, and (3) Commercial Insurance. Global Life and Health consists of ERC's subsidiary, ERAC, and other European affiliated insurers. P&C Reinsurance consists of ERC, its European subsidiary reinsurers, and an affiliate, GE Reinsurance Corporation. Commercial Insurance includes ERC and its subsidiaries, WIC, FSIC, and IRI.

The Commercial Insurance P&L center is divided into sub-P&L's as follows: (1) Healthcare, (2) Specialty, (3) Industrial Risk Insurers, and (4) P&C Select. Another sub-P&L, Medical Protective, existed at December 31, 2003, but was eliminated as a result of General Electric's sale of The Medical Protective Company to Berkshire Hathaway in May 2005. The Industrial Risk Insurers sub-P&L involves the large property risks usually involving multiple locations. The subject properties insured by IRI require specialized engineers, inspectors, and technical personnel to appraise and evaluate the risks. All of the IRI business is written by WIC and then ceded 100% to ERC. Further information about IRI is included in the Affiliated Companies section and the Reinsurance section.

ERC writes or assumes various lines of business in all of the current sub-P&L's of Commercial Insurance. Excess worker's compensation insurance is ERC's oldest product that is marketed to self-insured employers and trusts. Hospital professional liability insurance is assumed on a facultative basis from captive insurers for larger hospitals and integrated health systems. Excess of loss medical insurance is sold to employers that self-insure the medical costs of its employees. Excess of loss reinsurance is written for health maintenance organizations, which provides coverage in excess of per member retentions.

The P&C Reinsurance division also has sub-P&L centers, as follows: (1) Global Brokers, (2) North America Direct, (3) Asia/Pacific Branches, (4) Continental Europe Branches & Specialty, (5) North America Casualty Facultative, and (6) Discontinued Operations. Most of ERC's business comes from the North America Direct sub-P&L. Specific reinsurance agreements are discussed in the Reinsurance section of this report.

The Company's direct policies are produced by an agency force consisting of 2,181 licensed independent agents. Reinsurance is sold through both in-house staff and outside brokers. Assumed business is generated by personal contacts, requests for bids, and the Company's web site.

Policy Forms & Underwriting
Advertising & Sales Materials
Treatment of Policyholders

The Missouri Department of Insurance has a market conduct staff that performs a review of these issues and generates a separate market conduct report. However, no market conduct examination reports from the MDI or any other state were issued for the examination period.

REINSURANCE**Premium Activity**

The Company's premium activity on a direct written, assumed and ceded basis, for the period under examination, is detailed below:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Direct Business	\$249,151,849	\$302,281,931	\$419,215,429
Reinsurance Assumed:			
Affiliates	806,601,296	880,893,310	740,197,414
Non-affiliates	2,402,857,781	2,806,814,317	2,381,270,206
Reinsurance Ceded:			
Affiliates	(10,546,556)	(48,024,466)	(106,721,853)
Non-affiliates	<u>(1,527,749,649)</u>	<u>(1,088,795,227)</u>	<u>(560,968,872)</u>
Net Written Premiums	<u>\$1,920,314,721</u>	<u>\$2,853,169,865</u>	<u>\$2,872,992,324</u>

Assumed Business - General

The table below lists the ceding companies with the largest percentage of ERC's 2003 assumed premiums and case loss reserves.

Name of Ceding Company	2003 Assumed Premium	12/31/2003 Assumed Case Losses and LAE
AFFILIATED:		
GE Frankona Ruckversicherung AG	(\$ 92,864,000)	\$1,590,855,000
Industrial Risk Insurers	259,973,000	819,604,000
GE Reinsurance Corporation	12,606,000	718,800,000
Westport Insurance Corporation	405,066,000	281,662,000
First Specialty Insurance Corporation	273,188,000	80,159,000
NON-AFFILIATED:		
Combined Specialty Insurance Company	189,562,000	175,045,000
Provident Life and Accident Insurance Company	0	143,230,000
Zurich American Life Insurance Company of Illinois	43,962,000	132,197,000
Connecticut Mutual Life Insurance Company	0	126,154,000
UNUM Life Insurance Company of America	4,794,000	89,206,000
American United Life Insurance Company	72,257,000	83,315,000
Hartford Life & Accident Insurance Company	38,131,000	82,178,000
Gulf Insurance Company	45,756,000	73,674,000
United National Insurance Company	89,465,000	41,777,000
Subtotal	<u>\$1,341,896,000</u>	<u>\$4,437,856,000</u>
Total for All Assumed Business	\$3,121,447,000	\$6,751,175,000

Subtotal Percentage of Total	42.99%	65.73%
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Assumed Business - Affiliated

The Company has significant business assumed from its subsidiaries and affiliates. The Company has numerous quota share, excess of loss, and facultative treaties to assume risks for specific lines of business.

ERC also has a program that has provided Whole Account Aggregate Excess of Loss (XOL) coverage for many subsidiaries and affiliates for several years. A separate agreement is executed for each accident year as protection for unfavorable underwriting results. Under the terms of the agreements, ERC assumes losses from the subsidiaries and affiliates covering the entire book of business of each company if incurred losses exceed a defined loss ratio. Each agreement has a minimum premium to be paid to ERC and if there are ceded losses, the premiums paid to ERC are percentages of the ceded losses, less the minimum premiums previously paid. The agreement terms are structured similar to the terms in ERC's Whole Account Aggregate XOL Agreements, which are described in the Ceded Business section of this report. Many of the Whole Account Aggregate XOL agreements have never had any ceded losses.

The assumed reinsurance agreements with the affiliates listed in the above table that had significant premiums or loss reserves were reviewed, as summarized below.

ERC has three Whole Account Aggregate XOL Retrocession Agreements with GE Frankona Ruckversicherung AG, a German subsidiary, which were effective for the 1999, 2000, and 2001 accident years. Per the terms of the Agreements, ERC assumes any net losses in excess of a 72% loss ratio subject to a maximum liability of \$750,000,000 for each accident year. GE Frankona Ruckversicherung AG will pay provisional premiums equal to 49%, 50%, and 52% of any losses ceded to ERC, subject to minimum premiums of \$12,000,000, \$15,000,000, and \$30,000,000 for the 1999, 2000, and 2001 accident years, respectively. The premiums will be adjusted based upon the premiums paid by ERC under its Whole Account Aggregate XOL Agreements, as described in the Ceded section below. ERC reported a total reserve of \$1,561,895,818, as of December 31, 2003, for the three Agreements. The Company could not provide a signed copy of the 2001 Agreement during the examination.

The Company has a Whole Account XOL Retrocession Agreement, effective January 1, 2000, with GE Frankona Ruckversicherungs AG. Per the terms of this Agreement, ERC assumes 20% of any loss in excess of \$25,000,000 per occurrence, subject to a limit of liability of \$10,000,000 per occurrence. GE Frankona Ruckversicherungs AG pays ERC a flat premium of \$2,877,050 each year. The Company could not locate a signed copy of this agreement. Only a placement slip from the broker was available for our review during the examination.

ERC has two Whole Account Aggregate XOL Retrocession Agreements with GE Reinsurance Corporation, which were effective for the 1999 and 2001 accident years. Per the terms of the Agreements, ERC assumes any net losses in excess of a 73% loss ratio for both years subject to a maximum liability of \$150,000,000 for 1999 and \$200,000,000 for 2001. The premium to be paid by GE Re will equal 50% of any losses ceded to ERC.

The Company has another Whole Account XOL Retrocession Agreement, effective January 1, 2001, with GE Re. Per the terms of this Agreement, ERC assumes any loss in excess of \$10,000,000 per occurrence, subject to a limit of liability of \$25,000,000 per occurrence and an aggregate limit of \$50,000,000 per year. GE Re pays ERC a flat premium of \$6,250,000 each year. The Company could not locate a signed copy of this agreement. Only an unsigned copy was available for our review during the examination.

ERC has a Quota Share Retrocession Agreement, effective June 27, 1997, with GE Re to assume 100% of the premiums and losses of GE Re's reinsurance agreements that are underwritten or managed by CORE Managers, Inc. GE Re receives a ceding commission of 3%.

The Company has a three separate Quota Share Reinsurance Agreements, all effective December 31, 2001, with its subsidiary, Westport Insurance Corporation. Under the nearly identical terms of all three agreements, ERC assumes 100% of the premiums and losses for the following three lines of business: worker's compensation policies referred to as the "Cybercomp" business program, lawyers' errors and omissions policies, and insurance agents and brokers professional liability policies. Westport receives a ceding commission, which ranges from 20% to 29%, under the terms of the Agreements.

ERC has a Casualty Excess of Loss Retrocession Agreement, effective January 1, 2002, with Westport and Coregis Insurance Company. For any direct written or assumed casualty policies, ERC will assume losses in excess of \$2,000,000 per occurrence, up to a maximum limit of \$8,000,000 per occurrence. Westport and Coregis will pay ERC premiums equal to 6% of the net premiums from casualty business less a 25% ceding commission retained by WIC and Coregis.

ERC has a Whole Account Aggregate XOL Retrocession Contract with Westport, which was effective for the 2003 accident year. Per the terms of the Contract, ERC assumes any net losses in excess of a 61% loss ratio subject to a maximum liability of \$60,000,000. The premium to be paid by Westport will equal 52% of any losses ceded to ERC with a minimum premium of \$1,200,000.

The business reported by the Company as assumed from IRI is actually ERC's 100% share of the premiums written by IRI, a voluntary association. The IRI business functionally operates as direct business for ERC, but is reported as assumed business in the Annual Statement. The actual policies are underwritten by Westport, which is also a member of IRI. There are no reinsurance agreements between ERC, IRI, or Westport.

The Company has a four separate Quota Share Reinsurance Agreements with its subsidiary, First Specialty Insurance Corporation. Three of the Agreements are effective December 31, 2001 and the other is effective June 30, 2002. Under the nearly identical terms of all four agreements, ERC assumes 100% of the premiums and losses for the following four lines of business: general liability and property coverages for small commercial businesses in the “GA Authority Excluding Windward” program, general liability policies for security guard firms in the “Costanza” MGA program, general liability and umbrella policies for construction and manufacturing businesses in the “Individual Risk Casualty” program, and comprehensive risk coverage for municipalities and school districts in the “Public Entity” program. First Specialty receives a ceding commission, which ranges from 15% to 26%, under the terms of the Agreements.

ERC has a Whole Account Aggregate XOL Contract with First Specialty, which was effective January 1, 2003. Pursuant to the terms of the Contract, ERC assumes 80% of the premiums and losses for all lines of business sold or assumed by First Specialty, excluding medical malpractice. The Company assumes 100% of premiums and losses for the medical malpractice business. The terms of this Contract are applied after the four 100% quota share Agreements with First Specialty. The business originally assumed 100% in the four quota share Agreements is reduced to 80% in this Contract by crediting First Specialty for the 20% difference. First Specialty receives an 8% ceding commission for any net amounts assumed by ERC.

ERC has a Whole Account Aggregate XOL Retrocession Contract with First Specialty, which was effective for the 2003 accident year. Per the terms of the Contract, ERC assumes any net losses in excess of a 54% loss ratio subject to a maximum liability of \$25,000,000. The premium to be paid by First Specialty will equal 52% of any losses ceded to ERC with a minimum premium of \$500,000.

The Company also has an Adverse Development Agreement with First Specialty, effective June 30, 2003, that applies to the 2002 and prior accident years. ERC and First Specialty agreed that, as of June 30, 2003, First Specialty’s cumulative paid losses and loss adjustment expenses (LAE), excluding unallocated LAE, plus the remaining loss and LAE reserves for the 2002 and prior accident years equaled \$168,537,000. The Agreement states ERC will reimburse First Specialty for any paid losses and LAE for the 2002 and prior accident years that exceed \$168,537,000. First Specialty paid a \$1,000,000 premium to ERC as consideration for the coverage provided.

The Company also has reinsurance agreements with the following affiliates: Coregis Insurance Company, Core Insurance Company, First Marine Insurance Company, GE Frankona Reinsurance A/S, and The Medical Protective Company (sold by GE in 2005 and is not currently and affiliate). The financial statement impact of the assumed premiums and loss reserves from these affiliates was not material, as of December 31, 2003.

Assumed Business – Non-Affiliated

Large national and multinational direct insurers as well as medium-sized regional insurers are the primary focus of ERC's assumed, non-affiliated business. Assumed business is underwritten on a treaty and facultative basis for various lines of business including automobile, property, general casualty, umbrella, workers compensation, medical malpractice, and professional liability. Liability lines accounted for the majority of assumed written premiums in 2003.

The most significant assumed reinsurance agreements with the non-affiliates listed in the table above were also reviewed. The types of policies assumed by ERC in the reinsurance agreements were from the following casualty lines: worker's compensation, individual and group disability, retroactive disability claims, directors' and officers' liability, long-term care, umbrella liability, and excess liability. One exception was noted below.

The Company has an excess of loss agreement, effective July 1, 1999, with Combined Specialty Insurance Company to assume worker's compensation policies. The Company could not locate a signed copy of this agreement. Only a placement slip from the broker was available for our review during the examination. Total assumed loss and LAE reserves reported by ERC for the July 1, 1999 agreement were \$168,550,540.

As explained above, the Company could not provide signed copies of several reinsurance agreements with several affiliates and non-affiliates. Either the agreements have never been signed by both parties or the signed agreements were lost due to poor recordkeeping. ERC's assumed reinsurance agreements involve significant transactions that are material to the financial statements. It is essential that the terms and conditions are finalized in written agreements that are signed by both parties. Placement slips or cover notes from a broker are not sufficient. Signed agreements will help to avoid any coverage disputes that could occur in the future. The Company is directed to perform a thorough search of its entire inventory of reinsurance agreements to identify any that are unsigned. Actions should be taken to obtain signed copies of existing agreements that are supposed to be in effect. The Company is further directed to implement recordkeeping procedures and controls to ensure that all future agreements are signed and maintained properly.

Ceded Business - General

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the reinsurance agreement.

Total ceded reserves, as of December 31, 2003 were \$4,923,249,000. Reserves ceded to the Corporate Aggregate Program accounted for \$3,501,000,000 or 71% of the total. Ceded property reserves for IRI were \$554,000,000 or 11% of the total, of which \$487,000,000 of this amount are for the World Trade Center claims. Another \$523,000,000 of ceded reserves for other property and casualty claims are mostly associated with casualty treaty excess and

facultative obligatory retrocessions from 1992 and prior. About half of the \$523,000,000 is for asbestos claims, environmental claims, and Michigan automobile unlimited PIP claims.

The largest reinsurers based upon ceded premiums and reserves, were as follows:

Reinsurer	2003 Ceded Premiums	12/31/2003 Ceded Loss and LAE Reserves
Centre Insurance Company	\$ 41,300,000	\$ 564,173,000
Federal Insurance Company	8,607,000	123,331,000
National Indemnity Company	17,952,000	1,084,705,000
National Union Fire Ins. Co. of Pittsburgh	57,679,000	1,033,054,000
Scandinavian Reinsurance Co. Ltd.	7,982,000	126,753,000
Underwriters Reinsurance Co. (Barbados)	<u>39,911,000</u>	<u>633,765,000</u>
Subtotal	\$173,431,000	\$3,565,781,000
 Total for All Ceded Business	 \$667,691,000	 \$4,923,249,000
 Subtotal Percentage of Total	 25.97%	 72.43%

The reinsurers listed above were all participants in the Corporate Aggregate Program. Reserves ceded for the Corporate Aggregate Program accounted for \$3,501,000,000 or 98% of total reserves ceded to the above listed reinsurers. See below for further explanations of this Program.

Ceded Business – Division Programs

The following explanations were taken from the December 31, 2003 actuarial report prepared by the Company.

ERC's ceded reinsurance programs are designed to support the three operating divisions: P&C Reinsurance, Commercial Insurance, and Life and Health. With the exception of the Corporate Aggregate Program (described below), reinsurance is purchased separately for each division.

Reinsurance for the P&C Reinsurance division is purchased jointly to support writings within ERC, GE Reinsurance Corporation, GE Frankona Ruckversicherungs AG, GE Frankona Reinsurance Ltd., and GE Specialty Insurance (UK) Ltd. This joint reinsurance purchase practice has existed since 2002, when the GE Insurance Solutions was reorganized into three divisions.

ERC's worldwide property catastrophes for treaty reinsurance are retroceded for the layer of \$160,000,000 in excess of a \$40,000,000 retention per occurrence, with additional limits for non-U.S. exposures. These coverages are augmented by a program of property catastrophe contracts utilizing industry loss warranty retentions ranging from \$10,000,000,000 to \$30,000,000,000. Coverage is provided for up to approximately \$115,000,000 per occurrence above relatively

modest indemnity retentions. An additional property catastrophe protection of \$40,000,000 in excess of a \$15,000,000 retention is purchased for the Caribbean, Bermuda, Mexico, and South America.

ERC maintains retrocessional coverage for property facultative business on a per risk basis in the amount of \$85,000,000 excess of a \$15,000,000 retention. The first layer of this coverage is \$35,000,000 excess of \$15,000,000. It is provided by a pooled layer of coverage. Specifically, the pooled layer includes a \$170,000,000 aggregate limit per year for the combination of a number of property and casualty coverages. This second layer is \$50,000,000 in excess of \$50,000,000.

Worldwide casualty treaty business is retroceded for the layer of \$75,000,000 in excess of \$25,000,000 on a per occurrence basis. The first \$40,000,000 layer of this coverage is part of the pooled coverage described above for facultative property.

Workers compensation is retroceded for the layer of \$70,000,000 excess of \$7,500,000 per occurrence. The first \$40,000,000 layer of this coverage is part of the pooled coverage described above for facultative property.

ERC writes both casualty facultative business and also marine business. There is no retrocessional coverage for either program.

In addition to the above, ERC has a few specific loss retrocessions, both on a quota share and excess of loss basis, providing coverage for the assumed business of a few individual contracts and programs. These retrocessions are considered as exceptions to normal business practice. Ceded reserves for these retrocessions are not material.

Reinsurance programs for the Commercial Insurance division are purchased jointly to support business written within ERC (including business underwritten by IRI), Westport, First Specialty, and Coregis Insurance Company.

ERC reinsures property business on a per risk basis. The reinsurance program is on a pro rata basis. The program limits for IRI's maximum net retention to \$5,000,000 per risk. The net retention for other than IRI business is \$2,000,000. In addition, catastrophe reinsurance was purchased. For IRI, coverage limits are \$250,000,000 in excess of \$50,000,000 per occurrence. For other than IRI, the limits are \$135,000,000 in excess of \$25,000,000.

Hospital professional liability treaty and facultative reinsurance as well as direct business is retroceded/reinsured with limits of \$40,000,000 in excess of \$10,000,000 per occurrence. Miscellaneous professional liability business is reinsured with limits of \$8,000,000 in excess of \$2,000,000 per occurrence. ERC purchased a workers compensation catastrophe cover, providing coverage with limits of \$90,000,000 in excess of \$10,000,000 per occurrence.

ERC retrocedes a portion of group disability losses arising from quota share reinsurance it provides to a number of insurance companies. The retrocession is on a quota share basis with the

Disability Consulting Group (DCG). The DCG is a reinsurance pool providing coverage for the disability exposures of its members, which include ERC and other insurers.

Ceded Business – Corporate Aggregate Program

Since 1993, ERC has purchased annual whole account aggregate XOL protection on an accident year basis. Coverage includes losses incurred directly by ERC as well as losses incurred by ERC's subsidiaries and affiliates to the extent that those losses are ceded to ERC under aggregate excess of loss treaties provided by ERC. Management's main reason for purchasing the program was for catastrophe protection and general loss ratio protection. The Company's Whole Account Aggregate XOL Agreements for 1998 and prior, as well as 2002 and 2003, have all been commuted with no losses reported. The Agreements for accident years 1999 through 2001 have reached their maximum dollar recovery limits. The 1999 through 2001 Agreements are described in more detail in Note 7 of the Notes to the Financial Statements section of this report.

ERC discontinued the Corporate Aggregate Program beginning in 2004, as management stated that it became comfortable with other retrocession coverages that were in place and the Company's ability to absorb any net exposure that remained. Management further stated that discontinuance of the Corporate Aggregate Program increased ERC's exposure to catastrophe losses, a decision that was approved by senior management and GE.

ACCOUNTS AND RECORDS

The CPA firm, KPMG, LLP, of Kansas City, Missouri, issued audited statutory financial statements of the Company for all years in the examination period.

The actuarial opinion regarding the Company's reserves for losses and loss adjustment expenses was issued by John C. Narvell, FCAS, MAAA, FCIA, for all years in the examination period. Mr. Narvell is employed by the Company as the Chief Actuary, a position that is elected annually by the Board of Directors.

The Company closes its books and records for year-end transactions prior to December 31 of each year. ERC's ultimate parent, GE, requires its subsidiaries to provide early financial statement information to facilitate timely reporting of GE's consolidated financial statements. Thus, most of the assets and liabilities reported in the 2003 Annual Statement are not the balances as of December 31, 2003. For example, invested asset balances represent holdings as of December 17, 2003. Direct premiums, case loss reserves, and cash accounts represent balances as of December 18, 2003. Other timing problems occur from the information reported from ceding companies on reinsurance assumed business. The Company is directed to disclose its accounting practice for reporting asset and liability balances with dates prior to December 31 in the Notes to the Financial Statement section of the Annual Statement. Such disclosure is required by SSAP No. 1, paragraph 5 (Disclosure of Accounting Policies). Each year, the various cut-off dates that are used should be disclosed and the applicable asset and liabilities that are affected by each cut-off date.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of Employers Reinsurance Corporation for the period ending December 31, 2003. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the “Notes to the Financial Statements.” The failure of any column of numbers to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the “Notes to the Financial Statements.” These differences were determined to be immaterial concerning their effect on the financial statements, and therefore, were only communicated to the Company and noted in the workpapers for each individual Annual Statement item.

Assets as of December 31, 2003

	<u>Assets</u>	Non-Admitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$9,523,537,050	\$0	\$9,523,537,050
Preferred Stocks	296,746,408	0	296,746,408
Common Stocks (Note 1)	3,110,901,468	0	3,110,901,468
Cash and Short-Term Investments	582,643,101	0	582,643,101
Other Invested Assets	63,801,645	0	63,801,645
Receivable for Securities	155,330,891	0	155,330,891
Investment Income Due and Accrued	120,295,905	0	120,295,905
Uncollected Premiums and Agents' Balances in the Course of Collection	303,632,000	8,827,594	294,804,406
Deferred Premiums, Agents' Balances Booked But Deferred and Not Yet Due	432,381,511	26,097,923	406,283,588
Accrued Retrospective Premiums	109,011,615	176,856	108,834,759
Amounts Recoverable from Reinsurers	309,292,609	0	309,292,609
Funds Held by or Deposited with Reinsured Companies	17,751,932	2,430,808	15,321,124
Federal Income Tax Recoverable (Notes 2, 3)	701,657,675	0	701,657,675
Net Deferred Tax Asset (Note 4)	380,108,670	178,949,575	201,159,095
EDP Equipment and Software	2,257,028	0	2,257,028
Furniture and Equipment	16,616,855	16,616,855	0
Receivables from Parent, Sub., and Affiliates	18,104,648	0	18,104,648
Other Assets Nonadmitted	<u>88,804,021</u>	<u>88,804,021</u>	<u>0</u>
TOTAL ASSETS	<u>\$16,232,875,032</u>	<u>\$321,903,632</u>	<u>\$15,910,971,400</u>

Liabilities, Surplus and Other Funds as of December 31, 2003

Losses (Note 5, 6)	\$ 6,875,522,096
Reinsurance Payable on Paid Loss and LAE	47,233,620
Loss Adjustment Expenses (Note 5, 6)	631,607,051
Commissions Payable	14,061,776
Other Expenses	164,507,507
Taxes, Licenses and Fees	215,677
Unearned Premiums	1,366,624,049
Ceded Reinsurance Premiums Payable	41,923,742
Funds Held by Company Under Reinsurance Treaties	2,075,894,925
Amounts Withheld or Retained	6,042,573
Remittances and Items Not Allocated	0
Provision for Reinsurance	184,429,220
Net Adjustment Due to Foreign Exchange Rates	87,135,315
Payable for Securities	225,802,753
Aggregate Write-In Liabilities:	
Retroactive Reinsurance Reserve Assumed	<u>22,487,148</u>
TOTAL LIABILITIES	\$11,743,487,452
Common Capital Stock	5,000,000
Preferred Capital Stock	1,194,800,000
Gross Paid In and Contributed Surplus	3,104,953,569
Unassigned Funds (Surplus)	<u>(137,269,621)</u>
Capital and Surplus	<u>\$ 4,167,483,948</u>
TOTAL LIABILITIES AND SURPLUS	<u>\$15,910,971,400</u>

Statement of Income

For the Year Ended December 31, 2003

Premium Earned	\$2,778,796,760
DEDUCTIONS:	
Losses Incurred	1,888,962,410
Loss Expenses Incurred	208,277,296
Other Underwriting Expenses Incurred	<u>852,052,045</u>
Total Underwriting Deductions	<u>\$2,949,291,751</u>
Net Underwriting Loss	(\$ 170,494,991)
Net Investment Income Earned	1,071,570,025
Net Realized Capital Losses	<u>(1,685,678,896)</u>
Net Investment Loss	(\$614,108,871)
Other Income	(719,287)
Federal Income Taxes Incurred	<u>(29,936,008)</u>
Net Income	<u>(\$755,387,141)</u>
CAPITAL AND SURPLUS ACCOUNT:	
Surplus as Regards Policyholders, December 31, 2002	\$4,431,736,082
Net Income	(755,387,141)
Change in Net Unrealized Capital Gains or (Losses)	1,911,705,265
Change in Net Unrealized Foreign Exchange Capital Gain	5,131,695
Change in Net Deferred Income Tax	(63,075,959)
Change in Nonadmitted Assets	52,995,710
Change in Provision for Reinsurance	117,014,747
Paid-In Capital	(22,500,000)
Transferred to Capital (Stock Dividend)	(468,409,682)
Dividends to Stockholders	(89,860,000)
Examination Changes	<u>(951,866,769)</u>
Surplus as Regards Policyholders, December 31, 2003	<u>\$4,167,483,948</u>

Notes to the Financial Statements

Note 1 – Common Stocks

\$3,110,901,468

ERC owns 100% of the Class C common stock of GE Investments, Inc. ERC's book value for its investment in GE Investments was \$2,100,084,077, as of December 31, 2003, which represented 41% of capital and surplus. As explained in the Affiliated Companies section of this report, the assets backing the Class C common stock of GE Investments are several European insurance and reinsurance companies that are subsidiaries of OP Holdings, Inc., a holding company.

The Company's value for GE Investments, as of December 31, 2003, was based upon unaudited GAAP financial statements that were prepared by ERC. The Company made statutory accounting adjustments to the GAAP basis financial statements to derive the values reported in the 2003 and 2004 Annual Statements. ERC's valuation of GE Investments was in accordance with Interpretation (INT) 00-01: Investment In Foreign SCA Entity, from the NAIC Accounting Practices and Procedures Manual. This Interpretation stated that investments in foreign subsidiaries shall be valued upon the admitted asset equivalent method in Part 8, Section 3(g) – currently numbered as Section 3(b)(iv)(A) - of the Purposes and Procedures Manual of the Securities Valuation Office. This obscure guidance was necessary at the end of 2003 because SSAP No. 46 (Investments in Subsidiary, Controlled, and Affiliated Entities), which was in effect at that time, provided no guidance for the valuation of foreign subsidiaries.

ERC submitted a SUB-2 filing to the Securities Valuation Office (SVO) of the NAIC for the valuation of GE Investments. The SVO issued a letter confirming the value of \$2,100,084,077, as reported by ERC in its 2003 Annual Statement. The MDI relied upon the SVO to properly derive this valuation.

Note 2 – Federal Income Tax (FIT) Recoverable

\$701,657,675

The Company could not provide a complete reconciliation of the individual components that comprise the reported Annual Statement balance for the Federal Income Tax Recoverable line. Some components were identified, but most of the balance could not be reconciled. The Company is directed to annually reconcile the general ledger balances for income statement accounts with the actual provision for income taxes that is calculated by the tax department.

There was a difference of \$42,742,082 between the tax provision calculated by ERC's tax department and the actual recoverable recorded in the general ledger. This difference could not be reconciled and its origin is unknown. Since the general ledger balances were more conservative and no reconciliation was available, the Company considered the unreconciled amount a "cushion." However, no specific purpose for this "cushion" liability of \$42,742,082 was identified and the Company could not explain how the amount was derived.

Note 3 – Federal Income Tax (FIT) Recoverable**\$701,657,675**

The Company stated that a \$373,535,359 federal income tax recoverable for a capital loss carryback from the sale of ERC Life was included in the total balance of \$346,039,243 that was reported on the Annual Statement. However, as stated in **Note 2**, a complete reconciliation of the FIT recoverable could not be provided. Thus, it could not be verified that this amount was actually part of the total balance, as purported by the Company.

ERC Life was sold on December 22, 2003. The \$373,535,359 tax recoverable represents 50% of the total estimated tax benefit of \$747,071,918 resulting from the capital loss. The Company chose to admit only 50% as total recoverable to be conservative in the event that an IRS audit would disallow the deduction. The capital loss from the ERC Life sale was included in a loss carryback filing made by the ultimate parent, GE. A refund from the IRS was paid to GE on April 15, 2004, which included the full amount of the tax refund attributable to ERC for the ERC Life sale. Per terms of the Tax Allocation Agreement, ERC was not supposed to receive any of these funds until an IRS audit had been completed, which was projected to be sometime in 2008. The FIT recoverable of \$373,535,359 should have been non-admitted, pursuant to the requirements in paragraph 13 of SSAP No. 10, Income Taxes.

However, during the examination, GE decided to pay ERC its funds prior to any IRS audit as part of a plan to raise the capital and surplus of ERC. Wire transfers totaling \$729,153,791 were received by ERC on February 29, 2005. The difference between the original estimated tax benefit of \$747,071,918 and the cash received from GE results from a true-up from the estimated capital loss at the end of 2003 to the actual capital loss determined at the end of 2004. An examination change was made to increase FIT Recoverables by \$355,618,432, which is the amount of funds received from GE in excess of the recoverable booked for the capital loss on the sale of ERC Life.

Note 4 – Net Deferred Tax Asset**\$201,159,095**

The reported balance for Net Deferred Tax Assets (DTAs) was \$302,644,296, which consisted of \$362,667,587 of admitted DTAs and \$60,023,291 of deferred tax liabilities. The largest DTA was \$213,541,059 for loss reserves.

Paragraph 10 of SSAP No. 10 (Income Taxes) requires an admitted DTA to be a temporary timing difference that will be realized (reverse) in the next calendar. Any DTAs that will not reverse in the next calendar year must be non-admitted. SSAP No. 10 provides various methods for estimating the amount of loss reserves that will reverse in Exhibit A (Implementation Questions and Answers), paragraphs 5.9 through 5.13. ERC provided calculations for the one-year development method illustrated in paragraph 5.11. Pursuant to this method, the Company calculated that 37.7% of tax timing differences for loss reserves would reverse in 2004, which would have resulted in a DTA of \$112,055,858. However, the Company chose not to use this method.

As an alternative, the Company applied Q&A 13 of Exhibit A to derive its admitted DTA for loss reserves. Paragraph 13.1 states that the amount of a DTA that can be admitted may be based upon a “prudent and feasible” tax-planning strategy. An entity must demonstrate that it has a “prudent and feasible” tax-planning strategy that, if implemented, would result in the realization of DTA within one year of the balance sheet date. Paragraph 13.4 further states that “any potential costs associated with the implementation of the strategy should reduce the admitted DTA.”

ERC’s tax-planning strategy was to hypothetically enter into a retrocession agreement with an affiliate, CORE Reinsurance Company Limited (CORE Re), a Bermuda domiciled entity. The agreement would have been effective December 31, 2003. Under the terms of this hypothetical agreement, ERC would cede 100% of its net loss reserves for non-proportional liability lines of business for accident years 1995 through 2003 to CORE Re. The undiscounted net loss reserves that were recorded by ERC for this block of business were \$2,096,074,000, as of December 31, 2003. The premium to be paid to CORE Re would be equal to this amount of net reserves. The limit of liability of CORE Re would be \$2,410,485,100, which is 15% higher than ERC’s recorded reserves. It was explained that the 15% is to reflect risk transfer.

The Company stated that to support the retrocession agreement, ERC would need to infuse approximately \$300,000,000 of capital into CORE Re to make CORE Re a majority owned subsidiary of ERC. This transaction would require prior approval of the MDI, pursuant to Section 382.195 RSMo (Transactions Within a Holding Company System).

The estimated timing difference between book reserves and tax reserves for this block of business was \$490,053,000. The reversal of this timing difference would be 100% in 2004 if the reserves were ceded to CORE Re instead of 37.7% if the reserves were not ceded. The tax effect of this reversal created an additional DTA of \$101,485,201 for a total admitted DTA for loss reserves of \$213,541,059.

Numerous issues were identified that prevented this hypothetical agreement from conforming with the “prudent and feasible” requirement for a tax planning strategy, as required by Exhibit A of SSAP No. 10. These problems are as follows:

- It is unknown if CORE Re would actually sign such an agreement as proposed by ERC. CORE Re would basically have to commit in writing that it would be willing to execute such an agreement to make it feasible.
- The agreement has a clause that CORE Re may require additional consideration if its regulatory capital requirements change to require a material capital increase to support the reserves that would be assumed by CORE Re. The possibility and cost of such additional consideration is unknown.
- The agreement also requires CORE Re, as an unauthorized reinsurer, to provide ERC with collateral to secure the subject losses to be assumed by CORE Re. The Company proposed that the \$2,100,000,000 of ceded premiums to CORE Re would be kept in a trust account for the collateral. However, the proposed trust accounts would have annual fees and transaction charges. It is unknown if CORE Re has

the capability or would be willing to pay these fees. It is also unknown if ERC would pay for or reimburse CORE Re for any of the trust account fees.

- The Company did not quantify the impact upon ERC's investment income that would result from selling \$2,100,000,000 of its securities in order to pay ceded premiums to CORE Re. Supporting documentation indicated that there may be a loss in investment income due to a change in ERC's investment portfolio to support the proposed transaction.
- It is unknown if the agreement and all of the transactions affecting the agreement could have been accomplished within one year after December 31, 2003.

Due to the numerous uncertainties associated with the hypothetical agreement and related transactions, it does not appear to be a prudent and feasible strategy. The Company also did not identify all potential costs associated with the implementation of the strategy, as required by SSAP No. 10. Thus, an examination change was made to non-admit the \$101,485,201 DTA associated with ERC's strategy. The examples of prudent and feasible tax-planning strategies in SSAP No. 10 are those requiring unilateral actions of an insurance company. If the Company continues to pursue a strategy involving the actions of CORE Re, it should ensure that it acquires written commitments from CORE Re for all proposed transactions. The DTA derived from this tax planning strategy should be reported as a non-admitted asset until the uncertainties can be resolved, commitments are received from CORE Re, and all potential costs are identified and quantified.

Note 5 – Losses

\$10,232,367,517

Loss Adjustment Expenses

\$ 631,607,051

The MDI engaged Expert Actuarial Services, LLC (EAS) to perform an actuarial review of the loss and loss adjustment expense reserves of ERC. EAS issued an actuarial opinion and report to the MDI and determined that ERC's reported loss and LAE reserves of \$6,301,129,000, as of December 31, 2003, were deficient by \$1,062,000,000. An examination change was made to increase loss reserves by the indicated deficiency. This amount consists of the following components:

<u>Description</u>	<u>Deficiency</u>
Overly Optimistic Actuarial Assumptions – ERC	\$622,000,000
Overly Optimistic Actuarial Assumptions – First Specialty	58,000,000
Discounting of Reserves Overlap	144,000,000
Recording Lower Reserves than Actuarially Indicated	337,000,000
Asbestos and Environmental Reserve Understatement	47,000,000
Missing IBNR for 1983 and Prior	30,000,000
Redundancy in Calculated Reserves	<u>(32,000,000)</u>
Total Reserve Deficiency	\$1,206,000,000

EAS prepared independent analyses of the reserves for the six largest Commercial Insurance (direct) segments and the six largest Global Property and Casualty Reinsurance (assumed) segments of ERC. The direct lines reviewed were umbrella, workers compensation (three segments), automobile liability, and general liability. The assumed lines reviewed were general liability, workers compensation (two segments), and medical malpractice (three segments).

The direct and assumed workers compensation segments were found to be deficient by between 10% and 35%, with the direct segments the most seriously deficient. Contributing factors were ERC's selection of optimistic development factors, overly optimistic adjustments to case reserves, and unwarranted adjustments to reflect payment acceleration. The deficiency for the direct medical malpractice segments was attributable mostly to ERC's optimistic assertion that claim settlements have accelerated. Deficiencies for the assumed umbrella and general liability excess segments were attributable to somewhat optimistic development factors. EAS quantified the impact of adopting what was believed to be more reasonable assumptions and techniques, as compared to those used by ERC, to derive the \$622,000,000 deficiency for the twelve business segments that were analyzed.

EAS also prepared an independent analysis of the largest line of First Specialty, ERC's subsidiary. EAS' indicated reserves were \$96,514,000 for First Specialty's general liability, premises and operations line, in comparison to the \$38,764,000 of reserves recorded by ERC. The difference of \$58,000,000 (rounded) was due to ERC's selection of a development factor that was lower than any one of the historical development factors for this segment. First Specialty has a quota share reinsurance agreement with ERC and an aggregate excess of loss treaty with ERC that cedes virtually all of the indicated deficiency of \$58,000,000 to ERC.

Reserves for worker's compensation, assumed nonproportional liability, and other lines of business were discounted \$144,000,000 for accident years 1999 through 2001. The Company's Whole Account Aggregate Excess of Loss (XOL) Retrocession Agreements for those same years allow ERC to implicitly discount loss reserves by paying for worse than expected losses with future interest payments to related funds held accounts. EAS believes there is an overlap of the explicit discounting of reserves and the ceded amounts under the Whole Account Aggregate Excess of Loss Retrocession Agreements. Refer to Note 7 of the Notes to the Financial Statements section for a further description of the Aggregate XOL Agreements.

ERC's recorded reserves were \$337,000,000 less than the loss reserves that were indicated from quantitatively derived actuarial estimates. The Company's chief actuary made this management adjustment by using his professional judgement after reviewing the quantitative actuarial analysis prepared by ERC actuaries. The Company did not provide sufficient explanations to justify including the \$337,000,000 adjustment in the overall reserve determination. EAS determined that this adjustment was not warranted and therefore, this amount was added as a component of the overall deficiency.

ERC's analysis of asbestos reserves disregarded the trend of higher levels of payments in recent years. The Company attributed the recent high payments to statistical aberration. However, the data provided shows consistently higher payments instead of random spikes. This trend was utilized by EAS to estimate a deficiency of \$82,800,000 in asbestos reserves. This deficiency

was offset partially by a \$24,500,000 redundancy for environmental reserves. The net deficiency for asbestos and environmental reserves was \$47,000,000 (rounded), as determined by EAS.

The Company did not include any incurred but not reported (IBNR) reserves for 1983 and prior years, except for asbestos and environmental lines. EAS judgementally selected \$30,000,000 as the IBNR reserves for these years.

The final component of EAS' total indicated deficiency was a \$32,000,000 redundancy from ERC's method of booking reserves by determining the ratio of estimated ultimate losses to estimated earned premiums and applying that ratio to reported earned premiums. In some instances, this method had the effect of recording more reserves than would be indicated by the projection of ultimate losses. This redundancy was eliminated in EAS' reserve analyses.

Schedule P of ERC's 2004 Annual Statement reported adverse development of incurred losses and loss adjustment expenses of \$1,047,390,000 from December 31, 2003 to December 31, 2004. Per information provided by ERC, the Company recorded \$905,000,000 of reserve strengthening adjustments in 2004 to account for the majority of the development. ERC's reserve strengthening adjustments and the overall one-year adverse development in 2004 supports the reasonableness of the \$1,062,000,000 reserve deficiency that was determined by EAS.

As a result of the large deficiency in ERC's loss reserves, as determined by EAS, the MDI engaged EAS to perform an additional reserve analysis, as of December 31, 2004. Refer to the Subsequent Events section of this report for further details on this updated analysis.

Note 6 – Losses	\$10,232,367,517
Loss Adjustment Expenses	\$ 631,607,051

ERC has recorded credits on its Annual Statements from 1999 to 2004 for reserves ceded under its Whole Account Aggregate Excess of Loss (XOL) Retrocession Agreements for accident years 1999, 2000, and 2001. The amounts of ceded reserves were as follows:

Ceded Loss Reserves	
<u>Year</u>	<u>As of December 31</u>
1999	\$ 619,868,389
2000	1,703,468,269
2001	3,193,583,422
2002	3,529,305,875
2003	3,500,845,421
2004	3,500,845,421

A further breakdown of the reserves ceded, as of December 31, 2003, to the Aggregate XOL Agreements, is as follows:

Accident Year	Treaty Number	Reinsurer	Part. %	Ceded Reserves at 12/31/2003
1999	E1	National Indemnity	100%	\$ 500,000,000
1999	E2	Centre Insurance	45%	245,155,162
1999	E2	Federal Insurance	10%	54,478,925
1999	E2	National Union Fire	45%	245,155,162
Subtotal – 1999				1,044,789,249
2000	E1	National Indemnity	100%	500,000,000
2000	E2	Centre Insurance	40%	275,410,469
2000	E2	Federal Insurance	10%	68,852,617
2000	E2	National Union Fire	50%	344,263,086
Subtotal - 2000				1,188,526,172
2001	E5-7	National Indemnity	5%	63,376,500
2001	E5-7	National Union Fire	35%	443,635,500
2001	E5-7	Underwriters Re	50%	633,765,000
2001	E5-7	Scandinavian Re	10%	126,753,000
Subtotal - 2001				1,267,530,000
Total for Aggregate XOL Treaties				\$3,500,845,421

In 1999 and 2000, the Company had two layers of the Aggregate XOL Agreements. The 1999 First Whole Account Aggregate XOL Agreement (E1) with National Indemnity Company (National Indemnity) ceded ERC's losses between a 76.25% loss ratio and a 107.5% loss ratio, subject to a maximum of \$500,000,000. The Second Whole Account Aggregate XOL (E2) Agreement with Centre Insurance Company (Centre Insurance), National Union Fire Insurance Company of Pittsburgh (National Union Fire), and Federal Insurance Company (Federal Insurance) had ceded ERC's losses between a 70% loss ratio and a 76.25% loss ratio and losses in excess of a 107.5%, subject to a combined maximum of \$800,000,000. The E1 and E2 Agreements for 2000 were with the same reinsurers as the 1999 Agreements and terms were also similar. The 2000 E1 Agreement ceded ERC's losses between an 80.25% loss ratio and a 111.5% loss ratio, subject to a maximum of \$500,000,000. The 2000 E2 Agreement ceded losses between loss ratios of 74% and 80.25% in losses in excess of a 111.5% loss ratio, subject to a maximum of \$800,000,000.

In 2001, the Company had three Aggregate XOL Agreements (E5-7) among National Indemnity, National Union Fire, Underwriters Reinsurance Company (Barbados) Inc. (Underwriters Re), and Scandinavian Reinsurance Company, Ltd (Scandinavian Re). The retention, premiums, and limits of all three of the 2001 Agreements were nearly identical. The E5-7 Agreements ceded ERC's losses in six layers between a 74.75% loss ratio and a 129.86% loss ratio, subject to a combined maximum of \$1,267,000,000.

SSAP No. 62, Property and Casualty Reinsurance, defines the requirements for risk transfer in reinsurance agreements. Paragraph 9 of SSAP No. 62 requires a reinsurance contract to transfer risk to the reinsurer in order for the ceding company to record a credit for ceded loss reserves. Paragraph 75 states that all reinsurance agreements entered into on or after January 1, 1994 are subject to the requirements of SSAP No. 62. Thus, SSAP No. 62 is the statutory authority for risk transfer to evaluate all of ERC's Aggregate XOL Agreements from 1999 to 2001.

The MDI engaged Expert Actuarial Services, LLC, to perform a review of ERC's Aggregate (XOL) Agreements for 1999, 2000, and 2001. The purpose of EAS' review was to determine if the Agreements properly transferred insurance risk from ERC to the reinsurers, in accordance with the definitions in paragraphs 9 through 16 of SSAP No. 62. EAS issued a report and opinion to the MDI and determined that the Aggregate XOL Agreements for 1999, 2000, and 2001 did not transfer risk to the reinsurers, in accordance with the requirements of SSAP No. 62, paragraphs 9 through 16. Specific findings that led to EAS' conclusions are discussed in detail below.

Paragraph 12.b. of SSAP No. 62 prescribes that in order for risk transfer to exist in a reinsurance agreement, it must be "reasonably possible that the reinsurer may realize a significant loss from the transaction." Paragraphs 14 and 15 of SSAP No. 62 require the ceding entity (ERC) to evaluate the net present value of cash flows under reasonably possible outcomes to determine if the requirements of paragraph 12.b. have been satisfied. The Company provided documentation that purportedly demonstrated sufficient risk transfer in the Aggregate XOL Agreements. The analyses for each Agreement consisted of several cash flow models of the net present value gains or losses that would be realized by the reinsurers under varying loss ratios of ERC. Each set of analyses was further supported by narrative memos. The analyses and memos were completed by ERC personnel and its consultants prior to the execution of each of the Aggregate XOL Agreements.

ERC claimed that risk was transferred to the reinsurers when one of its model scenarios resulted in a 10% loss to the reinsurers. EAS determined that the Company's net present value analyses of cash flows and supporting memos did not demonstrate that it was reasonably possible for the reinsurers to realize a significant loss, as required by paragraph 14 of SSAP No. 62, and did not demonstrate that there could be a significant loss to the reinsurers, as required by paragraph 15.

EAS determined that the cash flow scenario models constructed by ERC were significantly flawed and included unrealistic and unreasonable assumptions. Some of the errors identified by EAS were as follows:

- Estimated total premiums were unreasonably low, which had the effect of speeding up the dates of ERC's recoveries from the reinsurers in the models.
- The payment patterns for ERC losses were modeled over an unreasonably quick time frame for both catastrophe and non-catastrophe losses.
- The payment patterns failed to account for the delays in loss payments from the corporate aggregate excess treaties ERC provided for its subsidiaries.
- Loss recoveries from the reinsurers were incorrectly assumed to be recovered at the beginning of each year.

The effect of these errors in the cash flow models was to overstate the projected net present value loss that would be realized by the reinsurers under all of the various loss ratio scenarios. Further, As identified by EAS, a critical omission in the Company's documentation was that there was no analysis or explanations for the probability (i.e., 10% chance, 15% chance, etc.) of a 10% loss that was shown in the models. Thus, the Company did not address the "reasonably possible" requirement of SSAP No. 62, paragraph 12.b.

EAS stated that all of the Aggregate XOL Agreements effectively discount loss reserves by calculating ceded premiums retrospectively as a percentage of the actual losses ceded under the Agreements. Premiums were not determined until after the term of each Agreement had expired on December 31 and incurred losses were determined. The premiums for the E1 Agreements for 1999 and 2000 were calculated by discounting the amount of ceded losses over nine years using an interest rate from a ten-year U.S Treasury Bond. The premiums for the E2 Agreements for 1999 and 2000 and the E5-7 Agreements for 2001 were calculated as percentages of the ceded losses. The resulting premium amounts paid by ERC were a large percentage of ceded losses, as follows:

Accident Year	Treaty Number	Ceded Premiums	Ceded Reserves* at 12/31/2003	Premium % of Recoveries
1999	E1	282,039,755	\$ 500,000,000	56.41%
1999	E2	392,000,000	644,789,248	60.80%
2000	E1	317,374,117	500,000,000	63.47%
2000	E2	354,000,000	688,526,172	51.41%
2001	E5-7	<u>766,052,623</u>	<u>1,267,530,000</u>	<u>60.44%</u>
Total		\$2,111,466,495	\$3,600,845,420	58.64%

*Includes \$100,000,000 of reinsurance recoverables for the 1999 E2 Agreement

Because of the direct correlation between premiums and losses in the Agreements, EAS stated that it was almost guaranteed that the reinsurers would not experience a net present value loss. This results from ceded premiums plus investment income earned on the ceded premiums exceeding the amount of losses ceded to the reinsurers. The Agreements eliminated the risk of varying the severity of losses incurred by ERC by proportionally increasing premiums as losses increase. The reinsurers effectively mitigated the risk of an underwriting loss due to the premium structure.

Based upon its opinion of a lack of risk transfer in the Aggregate XOL Agreements, EAS recommended several changes to the financial statements of ERC. SSAP No. 75, Reinsurance Deposit Accounting, provides the accounting guidance for all reinsurance agreements that do not transfer risk to the reinsurer. The examination changes to ERC's financial statements that would have been required to properly account for the Agreements per the guidelines of SSAP No. 75, are described as follows. Reserves recorded on the Losses line would need to be increased by \$3,501,845,421 to remove the reserve credits that had been recorded by ERC for the Aggregate XOL Agreements. The Amounts Recoverable from Reinsurers line would be decreased by \$100,000,000 to eliminate the recoverables booked for the 1999 E2 Agreement. Assets of \$1,837,810,407 would need to be shown as an Aggregate Write-In Asset, which would represent the ceded premiums (plus interest) recorded by ERC for the E2 and the E5-7 Agreements for 1999, 2000, and 2001 that were included in the Funds Held Under Reinsurance Treaties line. Finally, assets totaling \$705,903,002 would need to be recorded on an Aggregate Write-In Asset line for premiums ceded (plus interest) for the E1 Agreements. Actual ceded premiums to the E1 Agreements were \$282,039,755 and \$317,374,117 for 1999 and 2000, respectively. Investment earnings were added at the annual rate of 5% to approximate the yield, as specified in SSAP No. 75.

The net effect of restating ERC's financial statements would have resulted in a \$1,057,032,012 decrease to capital and surplus. If the same changes would have been made, as of December 31, 2004, the net effect would have been a \$924,972,645 decrease to capital and surplus. The reduced impact for restating the 2004 financial statements is due to investment income earned on ceded premiums during the year, which would increase the balances of Aggregate Write-In Asset lines that were described above.

National Union Fire, to which ERC ceded over \$1 billion of loss reserves at year-end 2003 and 2004, amended its 2004 Annual Statement to account for the Aggregate XOL Agreements under the deposit accounting method of SSAP No. 75. National Union Fire did not show any reserves assumed from ERC for any of the Aggregate XOL Agreements. National Union Fire has apparently concluded that the Agreements do not adequately transfer risk, as evidenced by the restatement of their financial statements.

Due to the significant impact of the risk transfer issue on ERC's financial condition, the MDI decided to obtain a second actuarial opinion. The MDI engaged INS Consultants, Inc. (INS) to also perform a review of ERC's Aggregate XOL Agreements for 1999, 2000, and 2001 for purposes of assessing risk transfer. INS issued a report to the MDI and determined that the Aggregate XOL Agreements for 1999, 2000, and 2001, although containing financial characteristics, satisfy the criteria to transfer risk to the reinsurers, in accordance with the

requirements of SSAP No. 62, paragraphs 9 through 16. Specific findings that led to INS' conclusions are discussed in detail below.

INS reviewed the report of EAS and considered the items that, in EAS' opinion, were determined to be flaws, unreasonable and unrealistic assumptions in ERC's cash flow models. INS concluded "that the modeling process for payment projections and catastrophe estimates is highly judgmental and variable, and there would be no material purpose served by attempting to alter the model calculations, which INS believes to be reasonable." INS stated that ERC's cash flow models supporting its risk transfer assertion were a realistic, good-faith attempt to measure reinsurer profit and loss and that the models demonstrated scenarios of significant losses ceded to the reinsurers. INS believes that the payout patterns used in the cash flow models were fair, average values.

INS' report addressed the criteria of paragraphs 12.b., 14, and 15 of SSAP No. 62 that states it must be "reasonably possible that the reinsurer may realize a significant loss" in any reinsurance agreement to establish transfer of risk. INS acknowledged that "while ERC's models do not quantify the catastrophe possibilities, INS' review concludes that large catastrophe losses are a reasonable likelihood." INS explained to the MDI that ERC's exposure to large catastrophe losses is the main reason they believe that the Aggregate XOL Agreements satisfy the "reasonably possible" requirement of paragraph 12.b. and 14 of SSAP No. 62. INS concluded that ERC's cash flow models were "sufficient to demonstrate...a significant loss under the broad guidelines of SSAP No. 62."

Thus, the MDI received conflicting opinions from two different actuarial firms about whether or not the Aggregate XOL Agreements for 1999, 2000, and 2001 properly transfer risk from ERC to the reinsurers. It should be noted that the Company's outside auditor, KPMG, also reviewed the Aggregate XOL Agreements, as part of their annual audits of ERC's financial statements. KPMG did not make any audit adjustments related to the Agreements, and therefore, apparently agreed that the Agreements transferred risk in accordance with SSAP No. 62. Due to the conflicting opinions, the MDI decided that no examination changes will be made for lack of risk transfer in this examination report. However, it should not be interpreted that the MDI agrees with ERC's accounting practices (from 1999 to current) for these Agreements and the MDI has not concluded that the Agreements properly transfer risk. The determination of risk transfer for the Agreements is highly subjective and debatable, based upon the opinions the MDI received from qualified actuaries. ERC's capital and surplus levels, as reported in the 1999 through 2004 Annual Statements, would be materially overstated if the Agreements do not transfer risk.

Any conclusion reached that the Agreements properly transfer risk may simply be due to the vague and poorly defined criteria of SSAP No. 62. There are no specific percentages or methods to quantify what is meant by the terms "reasonably possible" and "significant loss", which are the key criteria for the determination of risk transfer in SSAP No. 62. The risk transfer determination is subject to interpretation due to the lack of definitive criteria in SSAP No. 62. The Company has admitted and both consulting actuaries retained by the MDI agree that the Agreements contain many features to limit the risk to the reinsurers. The Agreements appear to have been crafted in such a way so that they function more like a financing device or loan, but still have some features that could be interpreted as achieving the transfer of minimal risk. If

there is any risk transferred to the reinsurers in ERC's Aggregate XOL Agreements, it appears to be a very low level of risk.

Paragraphs 29 and 30 of the Preamble to the Accounting Practices and Procedures Manual of the NAIC states the following:

“In order to provide a margin of protection for policyholders, the concept of conservatism should be followed when developing estimates as well as establishing accounting principles for statutory reporting. Statutory accounting should be reasonably conservative over the span of economic cycles and in recognition of the primary responsibility to regulate for financial solvency.”

This examination report has identified several large transactions and accounting practices of ERC that are straying from the conservatism concepts prescribed by the NAIC. This includes the Aggregate XOL Agreements that may or may not properly transfer risk to the reinsurers. The Subsequent Events section of this report describes how the Company's estimations of loss reserves have been consistently deficient for several years. **Note 4** of the Notes to the Financial Statements section describes a deferred tax asset that results from a planning strategy that is not “prudent and feasible.” The MDI recommends that the Board of Directors and management of ERC apply conservatism principles to its current accounting and reserving practices and also apply conservatism principles before implementing any future reinsurance agreements, accounting strategies, or other transactions where statutory authority is not well defined.

Examination Changes

Capital and Surplus Per Company, December 31, 2003:

Common Capital Stock	\$ 5,000,000
Preferred Capital Stock	1,194,800,000
Gross Paid In and Contributed Surplus	3,104,953,569
Unassigned Funds (Surplus)	<u>814,597,148</u>
Total Capital and Surplus Per Company	\$5,119,350,717

Examination Changes:

Increase Federal Income Tax Recoverable (Note 3)	\$ 355,618,432
Non-Admit Deferred Tax Assets (Note 4)	(101,485,201)
Increase Loss Reserves for Deficiency (Note 5)	<u>(1,206,000,000)</u>
Total Examination Changes	(\$ 951,866,769)

Capital and Surplus Per Examination, December 31, 2003:

Common Capital Stock	\$ 5,000,000
Preferred Capital Stock	1,194,800,000
Gross Paid-in and Contributed Surplus	3,104,953,569
Unassigned Funds (Surplus)	<u>(137,269,621)</u>
Total Capital and Surplus Per Examination	<u>\$4,167,483,948</u>

General Comments and/or Recommendations

GE Service Mark Agreement (page 22)

The Service Mark Agreement with GE Insurance Solutions, effective January 1, 2000, was never filed for prior approval with the MDI, as required by Section 382.195 RSMo. (Transactions Within a Holding Company System). The Company is directed to immediately submit this Agreement as part of a Form D filing to the MDI for approval. Payments made by ERC under this Agreement should cease until the Agreement is approved by the MDI.

Federal Tax Allocation Agreement (page 22)

There were federal income tax settlements during the examination period between the Company and several affiliates that were not parties to the Federal Tax Allocation Agreement. The affiliates were Med Pro, Coregis Group, Inc., CORE Insurance Holdings, GE Re, GE Reinsurance (Bermuda) Limited, and OP Holdings, Inc. The Company is directed to amend the Agreement to add these affiliates. Such amendment should be submitted in a Form D filing for prior approval with the MDI, as required by Section 382.195 RSMo (Transactions Within a Holding Company System).

Agreements Not Signed (pages 14 and 29)

The Company could not locate a signed copy of the Stock Purchase Agreement to purchase CORE Insurance Company, effective May 15, 2003. It was apparently lost or misplaced due to poor recordkeeping. The Company is directed to implement recordkeeping procedures to ensure that all significant agreements entered into by ERC are adequately maintained in its files.

The Company also could not provide signed agreements for the following intercompany agreements, that were reported in the 2003 and 2004 Form B filings: (1) Consulting Agreement with iProcess and other affiliates, (2) SOW No. 1 under the Managed Security Services Master Agreement with GE IT Solutions, Inc., (3) Services Agreement with GE Re, (4) SOW No. 4 under the Master Managed Services Master Agreement with GE IT Solutions, Inc. Therefore, these agreements were apparently never formally executed since they were never signed by the parties. The Company is directed to immediately execute these agreements and cease all transactions until the agreements are executed.

Intercompany Transactions without Agreements (page 32)

The Company had other intercompany transactions in the examination period that were not subject to any written agreement. Most of the transactions appeared to be for the sharing of joint expenses. The transactions were recorded in ERC's general ledger in various intercompany accounts with ERC Long Term Care Solutions, Inc., GE Insurance Solutions Corporation, GE Global Asset Protection Services, LLC (GE GAPS), and several subsidiaries of OP Holdings. The Company is directed to draft written agreements for the transactions that are occurring with these affiliates. The proposed agreements should be submitted in a Form D filing for prior approval with the MDI. The Company is further directed to cease transactions with these affiliates until agreements are approved by the MDI and signed by all parties.

Intercompany Transactions Not Reported (page 32)

Some intercompany transactions were not properly reported on Schedule Y – Part 2 of the Annual Statement. All payments made or received for the Master Cost Allocation Agreement with ERC Asia Pacific, the Service Reimbursement Agreement with GE, and the Service Mark Agreement with GE Insurance Solutions Corporation were improperly omitted. Transactions that occurred without an underlying written agreement, as identified in the preceding paragraph, were not reported on Schedule Y – Part 2. Also, ERC's purchase of GEI stock for \$300,000,000 in 2002 was another transaction not reported. The Company is directed to implement accounting procedures to track all transactions with affiliates and subsidiaries to ensure the complete reporting of these transactions on Schedule Y – Part 2.

Disclosure of Assets in Trust Accounts (pages 34 and 35)

The Company is the grantor in a Trust Agreement, dated July 1, 2002, with American United Life Insurance Company (AULIC) as the named beneficiary. The Company is also the grantor in a Trust Agreement, dated August 28, 2003, with United National Insurance Company (UNIC). The NAIC Annual Statement Instructions require disclosure of assets in trust accounts, since these assets are not for the benefit of all policyholders, claimants, and creditors of the Company. The Company is directed to report trust account assets with AULIC and UNIC on Schedule E – Part 3 – Special Deposits of the Annual Statement in the future.

Unsigned Reinsurance Agreements (page 41)

The Company could not provide signed copies of several reinsurance agreements with the following affiliates and non-affiliates: GE Frankona Ruckversicherungs AG, GE Reinsurance Corporation, The Medical Protective Company, and Combined Specialty Insurance Company. Either the agreements have never been signed by both parties or the signed agreements were lost due to poor recordkeeping. It is essential that the terms and conditions are finalized in written agreements that are signed by both parties. Placement slips or cover notes from a broker are not sufficient. Signed agreements will help to avoid any coverage disputes that could occur in the future. The Company is directed to perform a thorough search of its entire inventory of reinsurance agreements to identify any that are unsigned. Actions should be taken to obtain signed copies of existing agreements that are supposed to be in effect. The Company is further directed to implement recordkeeping procedures and controls to ensure that all future agreements are signed and maintained properly.

Year-End Reporting Dates (page 44)

The Company closes its books and records for year-end transactions prior to December 31 of each year. The Company is directed to disclose its accounting practice for reporting asset and liability balances with dates prior to December 31 in the Notes to the Financial Statement section of the Annual Statement. Such disclosure is required by SSAP No. 1, paragraph 5. Each year, the various cut-off dates that are used should be disclosed and the applicable asset and liabilities that are affected by each cut-off date.

Reconciliation of Tax Accounts (page 49)

The Company could not provide a complete reconciliation of the individual components that comprise the reported Annual Statement balance for the Federal Income Tax Recoverable line. Some components were identified, but most of the balance could not be reconciled. The Company is directed to annually reconcile the general ledger balances for income statement accounts with the actual provision for income taxes that is calculated by the tax department.

Deferred Tax Assets (pages 50-52)

The Company developed a tax-planning strategy that would require a retrocession agreement with an affiliate, CORE Reinsurance Company Limited (CORE Re), a Bermuda domiciled entity, and require ERC to acquire CORE Re by paying \$300,000,000. The tax effect of this strategy would create an additional DTA of \$101,485,201. Due to the numerous uncertainties associated with the hypothetical agreement and related transactions, it does not appear to be a “prudent and feasible” tax planning strategy, as required by Exhibit A of SSAP No. 10. The Company also did not identify all potential costs associated with the implementation of the strategy, as required by SSAP No. 10.

If the Company continues to pursue a strategy involving the actions of CORE Re, it should ensure that it acquires written commitments from CORE Re for all proposed transactions. The DTA derived from this tax planning strategy should be reported as a non-admitted asset until the uncertainties can be resolved, commitments are received from CORE Re, and all potential costs are identified and quantified.

Aggregate XOL Retrocession Agreements (pages 54-60)

The MDI engaged two actuarial consulting firms (Expert Actuarial Services, LLC and INS Consulting, Inc.) to perform a review of ERC's Aggregate (XOL) Retrocession Agreements for 1999, 2000, and 2001. The net capital and surplus impact of the Aggregate XOL Agreements was \$1,057,032,012, as of December 31, 2003, and \$924,972,646, as of December 31, 2004. The purpose of the reviews were to determine if the Agreements properly transferred insurance risk from ERC to the reinsurers, in accordance with the definitions in paragraphs 9 through 16 of SSAP No. 62. EAS issued a report and opinion to the MDI and determined that the Aggregate XOL Agreements for 1999, 2000, and 2001 did not transfer risk to the reinsurers, in accordance with the requirements of SSAP No. 62. INS issued a report to the MDI and determined that the Aggregate XOL Agreements for 1999, 2000, and 2001, although containing financial characteristics, satisfy the criteria to transfer risk to the reinsurers, in accordance with the requirements of SSAP No. 62.

Due to the conflicting actuarial opinions, the MDI decided that no examination changes will be made for lack of risk transfer in this examination report. However, it should not be interpreted that the MDI agrees with ERC's accounting practices (from 1999 to current) for these Agreements and the MDI has not concluded that the Agreements properly transfer risk. The determination of risk transfer for the Agreements is highly subjective and debatable, based upon the opinions the MDI received from qualified actuaries. ERC's capital and surplus levels, as reported in the 1999 through 2004 Annual Statements, would be materially overstated if the Agreements do not transfer risk.

Any conclusion reached that the Agreements properly transfer risk may simply be due to the vague and poorly defined criteria of SSAP No. 62. There are no specific percentages or methods to quantify what is meant by the terms "reasonably possible" and "significant loss", which are the key criteria for the determination of risk transfer in SSAP No. 62. The risk transfer determination is subject to interpretation due to the lack of definitive criteria in SSAP No. 62. The Company has admitted and both consulting actuaries retained by the MDI agree that the Agreements contain many features to limit the risk to the reinsurers. The Agreements appear to have been crafted in such a way so that they function more like a financing device or loan, but still have some features that could be interpreted as achieving the transfer of minimal risk. If there is any risk transferred to the reinsurers in ERC's Aggregate XOL Agreements, it appears to be a very low level of risk.

This examination report has identified several large transactions and accounting practices of ERC that are straying from the conservatism concepts prescribed by the NAIC. This includes the Aggregate XOL Agreements that may or may not properly transfer risk to the reinsurers. The Subsequent Events section of this report describes how the Company's estimations of loss reserves have been consistently deficient for several years. **Note 4** of the Notes to the Financial Statements section describes a deferred tax asset that results from a planning strategy that is not "prudent and feasible." The MDI recommends that the Board of Directors and management of ERC apply conservatism principles to its current accounting and reserving practices and also apply conservatism principles before implementing any future reinsurance agreements, accounting strategies, or other transactions where statutory authority is not well defined.

Loss Reserving Practices (pages 52-54, 69-70)

The MDI engaged Expert Actuarial Services, LLC (EAS) to perform an actuarial review of the loss and loss adjustment expense reserves of ERC. EAS issued an actuarial opinion and report to the MDI and determined that ERC's reported loss and LAE reserves of \$6,301,129,000, as of December 31, 2003, were deficient by \$1,206,000,000. ERC's reported reserves, as of December 31, 2003, were inadequate due to this large deficiency. The deficiency was due mostly to overly optimistic actuarial assumptions, double discounting of reserves, and management's decision to record reserves at amounts lower than estimated by the Company's actuaries.

Many of these same problems were found to exist from EAS' review of the December 31, 2004 reserves. EAS issued an actuarial opinion and report to the MDI and determined that ERC's reported loss and LAE reserves of \$7,339,992,000, as of December 31, 2004, were deficient on a net basis by \$664,000,000.

The loss and LAE reserves recorded by ERC have been deficient every year from 1999 through 2003, when compared to the actual development that occurred. These deficiencies correspond with the findings of MDI's consulting actuary, EAS. Management and the Board of Directors are directed to address the long history of reserve deficiencies that ERC has reported. All of the reserving issues reported by EAS, such as overly optimistic actuarial assumptions, the recording of reserves lower than the estimated amounts quantitatively determined by ERC's actuaries, and other problems should be corrected to reduce the likelihood of future reserve deficiencies.

SUBSEQUENT EVENTS

World Trade Center Litigation

ERC, through its 100% membership in IRI, insured portions of the property coverage for World Trade Center (WTC) buildings 1 and 2, which were destroyed in the terrorist attacks of September 11, 2001. Litigation involving the insurance coverage for WTC 1 and WTC 2 consists of a three-phase trial in New York City. Phase II of the trial dealt with the issue of whether the terrorist attacks constituted one occurrence or two occurrences. IRI's policy limits for WTC1 and WTC 2 were \$237,238,400, based upon a single occurrence. The Company also had additional liabilities for WTC 1 and WTC 2 from other reinsurance coverages. ERC established claim reserves in the 2003 Annual Statement on the basis of one occurrence.

On December 6, 2004, a federal jury verdict in Phase II found that the two airplanes that hit WTC 1 and WTC 2 represented two occurrences. The Notes to the Financial Statements of the 2003 Annual Statement stated that the maximum exposure from an unfavorable verdict in Phase II was \$300,000,000. However, after the Phase II verdict, the Company increased its reserves by \$100,000,000 in 2004, instead of the \$300,000,000 that was previously disclosed. The Notes to the Financial Statements of the 2004 Annual Statement stated that Phase III of the WTC trial is to determine the amount of loss that occurred. The \$100,000,000 was management's best estimate, as of December 31, 2004, of ERC's ultimate liability from the Phase II verdict. It appears that ERC may have additional exposure of \$200,000,000 depending on the results of Phase III of the trial, which was still in progress, as of the date of this report.

Building 7 of the WTC complex was also destroyed as a result of the terrorist attacks. ERC (through an IRI policy) insured 100% of the property coverage for WTC 7. Litigation involving the policy provisions and the valuation of the loss was pending at the end of 2003. Loss reserves, as of December 31, 2003, were set at the full policy limit of \$860,000,000 less approximately \$440,000,000 of claim costs that had previously been paid by ERC. On January 3, 2005, a Settlement Agreement and Release was executed between Silverstein Properties, Inc., the owner of WTC 7, and IRI. The Agreement stipulated that all pending litigation between the parties would be dismissed. The total property damage was agreed to be \$819,000,000 per the Agreement. IRI made final claim payments totaling \$303,445,111 to Silverstein Properties, Inc. on December 7, 2004. These payments were ceded 100% to ERC.

Finite Reinsurance Investigations

A series of subpoenas were issued in 2005 to ERC's ultimate parent, General Electric Company, from the following agencies, as follows:

- Securities and Exchange Commission (SEC), April 29, 2005
- Connecticut Attorney General, May 23, 2005
- U.S. Attorney's Office, June 13, 2005

The subpoenas were addressed to GE and its subsidiaries, including ERC. All of the subpoenas requested documents related to "finite risk" reinsurance agreements. The SEC subpoena and Connecticut Attorney General subpoena applied to transactions from January 1, 2000 to the present. The subpoena from the U.S. Attorney's Office required an appearance before a federal grand jury and applied to transactions from January 1, 1997 to the present.

The definition of "finite risk" varies, but usually is defined as a reinsurance transaction that transfers limited or no amounts of risk from a ceding company to a reinsurer, as compared to traditional reinsurance agreements. Considerable debate in the insurance industry surfaced during 2005 as to whether finite risk reinsurance agreements properly transfer enough risk to qualify as an insurance contract under generally accepted accounting principles (GAAP) and statutory accounting principles. The SEC subpoena and the U.S. Attorney's Office subpoena did not define the degree of risk transfer inherent in the term "finite risk." The Connecticut Attorney General subpoena defined "finite reinsurance" agreement as one in which there is "no substantial risk transfer between the parties."

In response to the SEC, Connecticut Attorney General, and U.S. Attorney's Office subpoenas, GE reported numerous agreements of ERC that were categorized as finite risk agreements. Included in GE's listing of finite risk agreements were ERC's Whole Account XOL Retrocession Agreements for 2000 (E1, E2 Agreements) and 2001 (E5-7 Agreements). The MDI's review of risk transfer in the Aggregate XOL Agreements was previously discussed in **Note 6** of the Notes to the Financial Statements section of this report.

The investigations of SEC, the Connecticut Attorney General, and the U.S. Attorney's Office were still in progress, as of the date of this report. The potential outcome and governmental actions that may result from these investigations and the possible effects upon ERC, cannot be assessed at this time.

Hurricane Activity

A series of large hurricanes occurred in 2004 and 2005 that caused material losses for ERC. Estimated losses from Hurricanes Charley, Frances, Ivan, and Jeanne in 2004 totaled \$399,000,000 on a gross basis and \$322,000,000 net of reinsurance. Estimated losses from Hurricane Katrina in 2005 were \$652,000,000 on a gross basis and \$230,000,000 net of reinsurance. Loss estimates were the latest information provided as of the date of this report.

Actuarial Review of December 31, 2004 Reserves

MDI's consulting actuary, EAS, reviewed the Company's loss and LAE reserves of \$7,339,992,000 that were reported, as of December 31, 2004. EAS issued an actuarial report and opinion to the MDI and determined that the reserves were deficient on a net basis by \$664,000,000 or 8.3%. Some of the same problems listed previously (in **Note 5** of the Notes to the Financial Statements section) for the large deficiency in the reported loss and LAE reserves, as December 31, 2003, continued to be problems for ERC's December 31, 2004 reserves. The Company continues to use overly optimistic actuarial assumptions, such as unreasonably low loss ratios and low trend rates. Management once again recorded loss reserves below the estimates that were quantitatively derived by ERC's actuaries. The Company failed to adjust for the overlap in the discounting of loss reserves that is created from the discounting for amounts ceded under the Whole Account Aggregate XOL Retrocession Agreements. Also, IBNR reserves for loss years of 1995 and prior were incorrectly omitted.

The table below shows the development of ERC's total loss and LAE reserves during the five-year period from 1999 through 2003, as reported in ERC's Annual Statements.

Year	Loss and LAE Reserves, as of	One-Year Deficiency	Percent	Two-Year Deficiency	Percent
	<u>December 31</u>	<u>(Redundancy)</u>	<u>Def.</u>	<u>(Redundancy)</u>	<u>Def.</u>
1999	\$4,729,175,000	\$ 112,261,000	2.4%	\$ 403,189,000	8.5%
2000	4,661,915,000	350,147,000	7.5%	1,886,799,000	40.5%
2001	4,642,744,000	1,883,350,000	40.6%	2,103,783,000	45.3%
2002	6,294,057,000	354,617,000	5.6%	1,564,787,000	24.9%
2003	6,301,129,000	1,047,390,000	16.6%	-na-	-na-

The table below shows the development of ERC's loss and LAE reserves, as of December 31, 2004, in comparison to the reserves originally recorded for each accident year from 1997 through 2003, as reported in ERC's Annual Statements.

Accident Year	Loss and LAE Reserves Recorded	Developed Loss and LAE Reserves	Cumulative	Percent
	<u>as of December 31 of Accident Year</u>	<u>Recorded as of December 31, 2004</u>	<u>Deficiency (Redundancy)</u>	<u>Deficiency (Redundancy)</u>
1997	\$ 972,657,000	\$ 1,297,232,000	\$ 324,575,000	33.4%
1998	1,247,227,000	2,039,379,000	792,152,000	63.5%
1999	1,356,905,000	2,133,621,000	776,716,000	57.2%
2000	1,544,773,000	2,333,999,000	789,226,000	51.1%
2001	1,842,247,000	2,554,336,000	712,089,000	38.7%
2002	1,777,425,000	2,135,271,000	357,846,000	20.1%
2003	1,821,520,000	1,658,740,000	(162,780,000)	-8.9%
	<u>\$10,562,754,000</u>	<u>\$14,152,578,000</u>	<u>\$3,589,824,000</u>	<u>34.0%</u>

As shown above by both tables, the loss and LAE reserves recorded by ERC are continually deficient for every year in recent history. These deficiencies support the findings of MDI's consulting actuary, EAS, as discussed previously.

Management and the Board of Directors are directed to address the long history of reserve deficiencies that ERC has reported. All of the reserving issues reported by EAS should be corrected to reduce the likelihood of future reserve deficiencies.

Acquisition by Swiss Re

On November 18, 2005, it was announced that GE had agreed to sell ERC's direct parent, GE Insurance Solutions, to Swiss Reinsurance Company (Swiss Re) for \$6.8 billion. The purchase excludes ERC's accident and health (A&H) business and ERC's subsidiary, ERAC. Numerous transactions have been proposed, which would significantly affect the organizational structure and financial statements of ERC. The significant proposed transactions that will impact ERC, are as follows:

- ERC will enter into a retrocession agreement to cede all of its A&H reserves to ERAC. ERC's net A&H reserves totaled \$773,937,802 and \$754,277,460, as of December 31, 2003 and December 31, 2004, respectively.
- ERC will dividend its investment in ERAC to GE Insurance Solutions. The book value of ERAC was \$399,824,146 and \$259,933,735, as of December 31, 2003 and December 31, 2004, respectively.
- ERC will redeem its investment in GE Investments for cash. The book value of GE Investments was \$2,100,084,077 and \$2,707,452,814, as of December 31, 2003 and December 31, 2004, respectively.
- ERC will dividend the proceeds from the redemption of the GE Investments stock to GE Insurance Solutions.
- ERC will strengthen its reserves for loss and loss adjustment expenses by approximately \$1,500,000,000, due to deficiencies identified by ERC and Swiss Re, as a condition of the purchase agreement.

The sale is expected to close in mid-2006 after regulatory approvals have been received. ERC's capital and surplus, as of the closing date in 2006, is projected to be \$3,200,000,000. Actual reported capital and surplus was \$5,119,350,717 and \$5,513,120,691, as of December 31, 2003 and December 31, 2004, respectively. As of the date of this report, the ERC legal entity was not expected to be redomiciled or merged due to the acquisition by Swiss Re.

ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Employers Reinsurance Corporation during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Leslie Nehring, Angela Campbell, CFE, Bernie Troop, CFE, Al Garon, CFE, Karen Baldree, CFE, and Andy Balas, CFE, examiners for the Missouri Department of Insurance, participated in this examination. The firm of Expert Actuarial Services, LLC, also participated as a consulting actuary.

VERIFICATION

State of Missouri)
)
County of Boone)

I, Tim L. Tunks, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of Employers Reinsurance Corporation, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Tim L. Tunks
Tim L. Tunks, CPA, CFE
Examiner-In-Charge
Missouri Department of Insurance

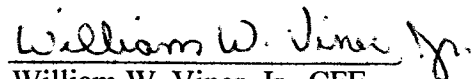
Sworn to and subscribed before me this 16th day of February, 2006.

My commission expires:

May 1, 2008

Debbie J. Nolke
Notary Public

DEBBIE J. NOLKE
Notary Public - Notary Seal
STATE OF MISSOURI
County of Boone
My Commission Expires May 1, 2008



William W. Viner, Jr., CFE

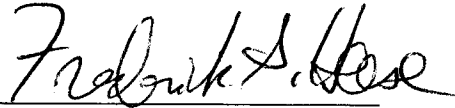
Examiner

Nevada Division of Insurance

Western Zone, NAIC

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.



Frederick G. Heese, CFE, CPA

Audit Manager

Missouri Department of Insurance



GE Insurance Solutions

Employers Reinsurance Corporation
9201 State Line Road
Kansas City, MO 64114
USA

April 28, 2006

VIA EXPRESS MAIL SERVICE

Mr. Kirk Schmidt
Chief Financial Examiner
Division of Financial Regulation
Missouri Department of Insurance
301 West High, Room 630
Jefferson City, MO 65101

RECEIVED
MO INS DEPT
MAY 05 2006

Re: Draft Report of Association Financial Examination (as of December 31, 2003)
Employers Reinsurance Corporation

Dear Mr. Schmidt,

Employers Reinsurance Corporation (ERC) is in receipt of the draft of the above-captioned report dated February 8, 2006 and provided to us for review on April 10, 2006. ERC appreciates the opportunity to review the report and provide comments. Accordingly, ERC respectfully requests that this letter be incorporated into or attached to the final financial examination report of the Missouri Department of Insurance (MDI).

In providing comments, ERC discusses each item in the order in which it was presented in the General Comments and/or Recommendations section of the draft examination report:

GE Service Mark Agreement: The draft report stated that the Service Mark Agreement between ERC and GE Insurance Solutions Corporation (GEISC), effective January 1, 2000, was not filed for prior approval through a Form D filing. The report includes a draft directive for ERC to do so. On March 24, 2006, ERC submitted a Form D to MDI concerning this agreement; on April 24, 2006, MDI issued a letter of non-disapproval with respect to this transaction.

Federal Tax Allocation Agreement: The draft report stated there were federal income tax settlements during the examination period between ERC and several affiliates that were not parties to the existing Federal Tax Allocation Agreement. The report includes a draft directive for ERC to amend the Agreement to add such parties. As of 2005, GEISC is the conduit through which tax settlements are conducted, rather than ERC; thus, GEISC settles with its subsidiaries, including ERC, and GEISC's subsidiaries settle with the entities beneath them. As a result, ERC does not settle tax matters with the other entities for which ERC was directed to amend the tax settlement agreement. Therefore, the suggested amendments no longer are necessary as all entities with which ERC would conduct federal income tax settlements are included in the present agreement.

Agreements Not Signed: The draft report stated that ERC could not provide signed copies of certain agreements during the course of the examination. The report includes draft directives for ERC to

implement recordkeeping procedures to ensure all significant agreements are adequately maintained and to execute existing intercompany agreements through which transactions are occurring. ERC is implementing processes to ensure that intercompany agreements are appropriately executed and maintained in company files. Regarding the four agreements ERC was directed to execute immediately, ERC notes that two of those agreements have terminated (Consulting Agreement with iProcess International, LLC and other affiliates and Statement of Work No. 4 with GE IT Solutions, Inc.). The other two agreements (SOW No. 1 under Managed Security Services Master Agreement with GE IT Solutions, Inc. and Services Agreement with GE Reinsurance Corporation) have been executed.

Intercompany Transactions without Agreements: The draft report stated that ERC entered into intercompany transactions during the examination period that were not subject to written agreement. The report includes draft directives that ERC prepare written agreements for these transactions, submit such agreements to MDI for approval through Form D filings, and cease such transactions until the agreements have been approved by MDI and executed by all parties. ERC is committed to correcting the issue prospectively within the context of the GE-Swiss Re transaction. Rather than drafting agreements with certain affiliates that may remain valid only for a short period time, ERC believes that current discussions will result in a comprehensive solution to any outstanding issues concerning intercompany services. Accordingly, ERC requests the opportunity to address this issue comprehensively and requests relief from the immediate directives of this section. ERC will submit to MDI for approval any agreements where such approval is required by Missouri law.

Intercompany Transactions Not Reported: The draft report stated that certain intercompany transactions were not properly reported on Schedule Y, Part 2 of the Annual Statement. The report includes a draft directive to implement accounting procedures to track all transactions with affiliates and subsidiaries to ensure the complete reporting of these transactions on Schedule Y, Part 2. ERC implemented new procedures in 2005 to ensure the accurate completion of Schedule Y, Part 2. These procedures address intercompany capital transactions as well as transactions relating to cost sharing agreements with affiliates.

Disclosure of Assets in Trust Accounts: The draft report stated that ERC did not disclose that assets in American United Life Insurance Company (AULIC) and United National Insurance Company (UNIC) trust accounts were not for benefit of policyholders, claimants, and creditors of ERC. The report includes a draft directive for ERC to report these trust account assets on Schedule E, Part 3 of the Annual Statement. Beginning with the 2005 Annual Statement, ERC reported trust account assets with AULIC and UNIC in Schedule E, Part 3.

Unsigned Reinsurance Agreements: The draft report stated that ERC could not provide executed copies of several specific affiliate reinsurance agreements. The report includes draft directives for ERC to perform a thorough search of its entire inventory of reinsurance agreements to identify any that are unsigned and to take actions to obtain signed copies of existing agreements. ERC is further directed to implement record keeping procedures and controls to ensure that all future agreements are signed and maintained properly. ERC has instituted a process to track all reinsurance contracts from inception, monitoring timely execution and electronic storage of final contracts.

Year-End Reporting Dates: The draft report stated that timing problems occur because of ERC's practice of closing its books and records prior to December 31. The report includes a draft directive for ERC to disclose its accounting practice for reporting asset and liability balances with dates prior to December 31 in the Notes to the Financial Statement section of the Annual Statement. Beginning with the 2005 Annual Statement, ERC disclosed in the Notes to the Financial Statements its accounting practice of reporting asset and liability balances with dates prior to December 31.

Reconciliation of Tax Accounts: The draft report stated that ERC could not provide a complete reconciliation of the individual components that comprise the reported Annual Statement balance for the Federal Income Tax (FIT) Recoverable line. The report includes a draft directive for ERC to reconcile annually the general ledger balances for income statement accounts with the actual provision for income taxes that is calculated by the Tax department. ERC management was aware that the recorded FIT Recoverable was less than the detailed supporting back-up materials and viewed this difference as a reasonable and prudent reserve with respect to inherent tax uncertainties that could be raised in subsequent Internal Revenue Service reviews. ERC's current system of internal control includes the quarterly reconciliation of current and deferred tax assets and liabilities and related tax provisions. These reconciliations are performed by the Controllers group and are subject to formal review and approval by the Tax department. Further, ERC routinely assesses the design and effectiveness of its control environment in accordance with the requirements of Section 404 of the Sarbanes-Oxley Act.

Deferred Tax Assets: The draft report included an examination change to non-admit the \$101,485,201 deferred tax asset in relation to ERC's tax planning strategy involving CORE Reinsurance Company Limited (CORE Re). The report stated the strategy did not appear to conform with the "prudent and feasible" requirements of Exhibit A of Statement of Statutory Accounting Procedure (SSAP) No. 10. While ERC disagrees with the draft report's conclusion that the tax planning strategy was not prudent and feasible, ERC did not pursue this strategy in 2005 in consideration of preliminary comments from MDI examiners.

Aggregate XOL Retrocession Agreements: The draft report opined that the terms of the Whole Account Aggregate Excess of Loss (XOL) Retrocession Agreements for accident years 1999, 2000, and 2001 may or may not transfer risk. The report stated such determination is subject to interpretation because of lack of definitive criteria in SSAP No. 62. The report included a draft recommendation that the Board of Directors and management of ERC apply conservatism principles to its current accounting and reserving practices and also apply conservatism principles before implementing any future reinsurance agreements, accounting strategies, or other transactions where statutory authority is not well defined.

In general, ERC believes that the discussion of the Aggregate XOL covers is unnecessarily negative. The report appears to disagree with some of the concepts of SSAP No. 62 and its predecessor Chapter 22. ERC is concerned both with the overall tone of the report's discussion of this issue and the manner in which facts and opinions are expressed. Specifically:

- The report does not fully discuss that ERC consistently conducted its own risk transfer analysis which was reviewed by its own external auditors and which was not found to be unreasonable or unsupported by information and data available at the time the contracts became effective.
- ERC's objections to both the process and the conclusions of MDI's consulting actuary, Mr. Dale Ogden, and his report are not mentioned.
- The bias of the verbiage used by the report's drafter, e.g., the underlining of "not" each time without equal emphasis and weight given to the conclusion by INS Consultants, Inc. that there was risk transfer.
- The previously stated criticism of SSAP No. 62 is repeated without recognition that SSAP No. 62 was the standard created by the NAIC that cedents and reinsurers are required to follow.
- The statements that the ERC Board of Directors did not apply conservative standards to their accounting practices, clearly imply that the statutory accounting rules are not adequate guides for the management of a regulated insurer and that the Board and ERC management

were somehow required to go beyond the conservatism that is inherent in, and the basis of, the statutory accounting rules.

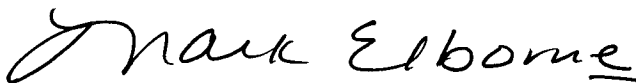
- The report appears to imply that the agreements may have been structured deliberately to act as financing devices and minimize risk transfer. To the contrary, as stated previously, ERC consistently conducted internal risk transfer analyses and the agreements were subject to external auditor review.

A reference to the treatment of the contracts by National Union has been included, yet the report fails to mention that (1) National Union's initial accounting treatment was consistent with ERC's and, most importantly, (2) GAAP literature specifically recognizes that two parties may have different opinions about risk transfer. While SSAP No. 62 is less expansive than GAAP comments with regard to risk transfer, they are consistent and it is only prudent for a company to review GAAP for further clarification of the applicable standard. In addition, at the time that the risk transfer analysis of these contracts was done, SSAP No. 62 had not been promulgated and ERC had only Chapter 22 and GAAP to use as guidance.

Loss Reserving Practices: The draft report discussed MDI's engagement of Expert Actuarial Services, LLC (EAS) to perform an actuarial review of ERC's loss and loss adjustment expense (LAE) reserves. EAS reported a loss and LAE reserve deficiency as of December 31, 2003 of \$1,206,000,000, the amount by which the report makes corresponding examination changes. The report includes a draft directive for the management and the Board of Directors of ERC to address recent reserve deficiencies to reduce likelihood of future reserve deficiencies. ERC has undertaken reserve strengthening to address adverse development, including \$1.5 billion in 2005 alone. Additionally, in 2005, ERC updated all significant actuarial assumption categories, which included a thorough review of those areas for which unintentional bias may have been present in prior assumptions. Losses reported since July 2005 appear to indicate that year-end 2005 reserve estimates are performing generally in line with expectations, and much better than prior years. ERC believes its recent actions reduce significantly the likelihood of future adverse development. ERC further believes that recent accident year loss ratios generally have been consistent with its competitors. Still, ERC regularly conducts rigorous reviews of its reserve position, and ERC management and the Board of Directors remain committed to ensuring ERC possesses adequate reserves in relation to its liabilities.

ERC appreciates the opportunity to provide these comments for consideration by MDI and inclusion in the final examination report. While ERC reserves the right to re-visit its proposed course of action following the close of the GE-Swiss Re transaction, we look forward to working with MDI in resolving any issues for which corrective action is required. If you have any comments or questions regarding these comments, please let us know.

Sincerely,


Mark Elborne
General Counsel

by: 